

United States
Circuit Court of Appeals

For the Ninth Circuit.

PEERLESS STAGES, INC., a Corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the
United States Board of Tax Appeals.

FILED

OCT - 1 1941

PAUL P. O'BRIEN,
CLERK

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES:

For Taxpayer:

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
ALBERT H. DAVIDSON.

For Comm'r:

T. M. MATHER, Esq.

Docket No. 100436

PEERLESS STAGES, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1939

Oct. 25—Petition received and filed. Taxpayer notified. Fee paid.

Oct. 25—Copy of petition served on General Counsel.

Dec. 12—Answer filed by General Counsel.

Dec. 12—Request for hearing in San Francisco filed by General Counsel.

Dec. 15—Notice issued placing proceeding on San Francisco Calendar. Answer and request served.

1940

- May 6—Notice of the withdrawal of Robert H. Perry filed. Consented to by taxpayer.
- May 6—Notice of the appearance of Clyde C. Sherwood, John V. Lewis and Albert H. Davidson, as counsel filed.
- Aug. 13—Hearing set October 7, 1940, San Francisco.
- Oct. 10—Hearing had before Mr. Sternhagen on merits. Submitted. Briefs due in forty days. No reply.
- Oct. 29—Transcript of hearing October 10, 1940, filed.
- Nov. 13—Brief filed by General Counsel.
- Nov. 18—Brief filed by taxpayer. November 18, 1940, copy served on General Counsel.
- Dec. 19—Findings of fact and opinion rendered. Sternhagen. Division 10. Decision will be entered for the respondent.
- Dec. 20—Decision entered. J. M. Sternhagen. Division 10.

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- Mar. 11—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.
- July 16—Proof of service filed by taxpayer.
- July 16—Certified copy of an order from the Ninth Circuit extending time to August 12, 1941, filed.

1941

July 17—Designation of the portions of the record, proceedings, and evidence to be contained in the record on appeal filed by taxpayer.

July 26—Stipulation re transmission of Exhibits 1 to 7 filed. [1*]

United States Board of Tax Appeals

Docket No. 100436

PEERLESS STAGES, INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency signed by the Internal Revenue Agent in Charge, San Francisco, dated July 31, 1939 (symbols IRA:90-D/CWB), and as a basis of this proceeding alleges as follows:

1. The petitioner is a corporation organized under the laws of the State of California, with principal office at 401 Pacific Building, Oakland, California.

2. The notice of deficiency, (a copy of which is

*Page numbering appearing at top of page of original certified Transcript of Record.

attached and marked Exhibit "A") was mailed to the petitioner on July 31, 1939.

3. The taxes in controversy are income taxes and excess profits taxes for the calendar year 1936. The deficiency asserted is \$34,899.24, the whole amount of which is in controversy.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) In determining the taxable net income of the petitioner for the calendar year 1936 the Commissioner erroneously increased the income \$119,705.58.

(b) The Commissioner erred in failing to allow the petitioner a cost basis of \$119,705.57 for the developed operative rights which rights the petitioner agreed to abandon under its agreement with Railway Equipment & Realty Company, Ltd. [2]

(c) In the sale of petitioner's busses and abandonment of operative rights and motor coach lines for which the petitioner received \$216,540.32 the Commissioner erroneously disallowed the capitalization of the cost of development of operative rights.

(d) The Commissioner erred in determining that under the Revenue Act of 1936, the petitioner had no authority to capitalize the cost of development of operative rights, and, also erred in determining that the profit from sale of busses and franchise amounted to \$212,040.32.

5. The facts upon which the petitioner relies as the basis for this proceeding are as follows:

((a) The petitioner entered into an agreement with Railway Equipment & Realty Company, Ltd., hereinafter designated as Equipment Company under date of January 14, 1936 under which petitioner was agreeable to abandoning certain of its motor coach lines and certain of its operative rights upon the performance of all the terms and conditions set forth in such agreement. Copy of said agreement is attached hereto and marked Exhibit "B".

Under the aforesaid agreement the petitioner reported as taxable income in its corporation income and excess profits tax return for the calendar year 1936 a capital gain of \$92,334.74 which amount represented the profit made on abandonment of operative rights. In its accounting records for the calendar year 1935 the petitioner capitalized the sum of \$119,705.58 representing the cost of development of operative rights.

The capitalized cost of \$119,705.58 set up by the petitioner was credited as at December 31, 1935 by journal entry with \$30,000.00 the offsetting charge being made to an account receivable. The total amount received by the petitioner under the agreement \$216,540.32 was therefore applied as [3] follows when received:

\$ 30,000.00 credited to account receivable
\$186,540.32 credited to income

Of the latter amount \$4,500.00 was allocated to income from the sale of busses. The amount of capitalized cost, \$89,705.58 offset against income in the petitioner's tax return for the year 1936 was applicable to years and amounts as follows:

Calendar Year 1931 cost.....	\$15,613.54
Calendar Year 1932 cost.....	11,230.94
Calendar Year 1933 cost.....	516.47
Calendar Year 1934 cost.....	39,459.22
Calendar Year 1935 cost.....	22,885.41
<hr/>	
Total Cost	<u><u>\$89,705.58</u></u>

The amounts restored to surplus in the calendar year 1935 after having been charged off as losses in the accounting records in prior years were as follows:

Calendar Years, 1931.....	\$15,613.54
1932.....	11,230.94
1933.....	516.47
1934.....	39,459.22
<hr/>	
Total.....	<u><u>\$66,820.17</u></u>

As at May 18, 1936 the petitioner remitted the following amounts to the Collector of Internal Revenue, San Francisco, California for purposes as follows:

Additional Income Tax—Year 1931.....	\$ 101.44	
Interest on above.....	25.46	
	<hr/>	
Total.....		\$ 126.90
Additional Income Tax—Year 1932.....	\$2,415.94	
Interest on above.....	316.08	
	<hr/>	
Total.....		\$2,732.02
Additional Income Tax—Year 1934.....	\$3,269.22	
Interest on above.....	231.57	
	<hr/>	
Total.....		\$3,500.79
		[4]

Amended income tax returns for the calendar years 1931 and 1932, and, amended income and excess profits return for the calendar year 1934 were filed with the Collector of Internal Revenue, San Francisco, California on May 18, 1936.

(b) A revenue agent of the Commissioner of Internal Revenue made a field examination of the petitioner's books and accounts for the calendar year 1935. Subsequently under date of January 20, 1937 the petitioner was advised by letter signed by C. W. Herrick, Internal Revenue Agent in Charge, San Francisco, that it was being recommended that the income tax return for 1935 be accepted as correct. At the date of such examination by the revenue agent the accounts of the taxpayer reflected the capitalization of the aforesaid amount of \$119,705.58 and the transfer of \$30,000.00 to an accrued receivable account as at December 31, 1935. The Commissioner did not take exception to the

capitalization of such costs or setting up the accrued receivable pursuant to or as a result of such examination to the best knowledge and belief of officers of the petitioner.

(c) The operative rights of the taxpayer for the operation of motor coach lines were acquired upon application to the Railroad Commission which is the regulatory body in the State of California.

(d) In the application for the acquisition of such operative rights by the petitioner a showing was required that public convenience and necessity demanded the proposed operations and further that such operations could be developed to a profitable basis. During the time of acquiring such rights only nominal costs were incurred. It was known by the officers of the petitioner at the time of acquisition of these rights that it would be necessary to make a considerable expenditure in order to develop the patronage of the motor coach lines operated thereunder. [5]

It therefore undertook a development program and used its capital to invest for a future benefit which actually materialized. The petitioner's officers realized that inasmuch as the petitioner performed no service locally within the City of Oakland, it was dependent, if it wished to develop its operative right, upon the adjacent San Leandro and Hayward territory. Upon a survey of the territory it was found that there was available in this area an abundance of homesites, ideal from point of view of climatic conditions and prices, and it was

also found that unless, frequent, economical transportation services that would provide service for commuters, shoppers, and those attending schools and business, were first provided, the settlement of the communities would be retarded.

The Company accordingly undertook, in 1931, its program of development along a so-called "E. 14th St. route." Local busses, effecting approximately a twenty minute headway between Oakland and Hayward were put into operation. It is essential to note that in the opinion of the officers of the petitioner that those then residing in the area were insufficient by far to warrant the operation of such a service. The service was put on to develop the territory, which in turn would develop an operative right of considerable value. It should be clear that the development program throughout was carried on for the benefit of future years. Exhibit "C" indicates how, under this plan, patronage was gradually attracted to the lines of the carrier during 1931, 1932 and 1933. At this point (the close of 1933) the receipts of the operation had been brought to a point that about equalled the annual expenses of the operation, and the development phase of that operative right was about completed.

However, the Company deemed it advisable in 1934 to embark upon a further program of development by applying to the State Railroad Commission for an operative right to serve the San Lorenzo and Castro Valley areas. These areas [6] are adjacent to the 1931 development program. The deterrent

to settlement in this area was likewise the lack of suitable transportation facilities. This same type of development program was instituted in this area. A twenty minute frequency over the San Lorenzo and Castro Valley routes was instituted, which in turn was co-ordinated with the existing service along E. 14th St., effecting a ten minute service between Hayward, San Leandro and Oakland. Exhibit "C" indicates how the installation of new service began bringing about new development in the area and new passengers to the operation.

The cost of this extra frequency of service over and above immediate needs was not incurred for immediate benefit, but was a definite cost incurred for the benefit of future years.

(e) The Railroad Commission granted the taxpayer the operative rights as hereinbefore described to the exclusion of other carriers and at the inception of the service it was considered by officers of the petitioner that a portion of the company's capital would necessarily be invested in developing the operative rights acquired.

(f) It was considered by officers of the petitioner that annual deficits of operation of bus lines as capitalized represented substantially the cost of development of the operative rights.

(g) It was also considered by officers of the petitioner that had the cost of development of operative rights been established by a segregation of expenses and costs that any incidental profit arising from operation under these operative rights would

be deductible from the development cost. This course of action it was also considered would, in effect, result in cost of development of operative rights equal to or substantially equal to the capitalized cost which the petitioner set up as at December 31, 1935. [7]

(h) The operative rights which the petitioner agreed to abandon in its agreement of January 14, 1936 with the Equipment Company were capital assets. These rights in the consideration of the petitioner's officers became valuable during the process of development of the operative rights.

6. Wherefore, the petitioner prays that this Board may hear the proceeding and determine that no deficiency be due from the petitioner for the calendar year 1936.

ROBERT H. PERRY

Counsel for Petitioner

Robert H. Perry

1706 Broadway

Oakland, California [8]

State of California,
County of Alameda—ss.

G. J. Weiser, being duly sworn deposes and says that he is the secretary of the petitioner above named and that he is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein, and that the statements contained therein are true, except as to those stated upon

information and belief, and those facts he believes to be true.

G. J. WEISER

Subscribed and sworn to before me this 23rd day of October, 1939.

[Seal] JESSIE MACPHERSON

Notary Public in and for the County of Alameda,
State of California.

My commission expires April 15, 1943. [9]

EXHIBIT "A"

Treasury Department
Internal Revenue Service
433 Federal Office Building
San Francisco, California

July 31, 1939

Office of
Internal Revenue Agent in Charge
San Francisco Division
IRA:90-D
CWB

Peerless Stages, Incorporated,
401 Pacific Building,
Oakland, California.

Sirs:

You are advised that the determination of your income tax liability for the taxable year December 31, 1936 discloses a deficiency of \$25,289.85 and that

the determination of your excess-profits tax liability for the year mentioned discloses a deficiency of \$9,609.39 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiencies mentioned.

Within 90 days (not counting ~~Sunday~~ or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By (Signed) F. M. HARLESS

Internal Revenue Agent in
Charge [10]

Statement

San Francisco

IRA :90-D

CWB

Peerless Stages, Incorporated

401 Pacific Building

Oakland, California

Tax Liability for the Taxable Year Ended

December 31, 1936.

	Liability	Assessed	Deficiency
Income Tax	\$36,923.15	\$11,633.30	\$25,289.85
Excess-profits Tax	9,609.39	None	9,609.39
	<hr/>	<hr/>	<hr/>
	\$46,532.54	\$11,633.30	\$34,899.24

In making this determination of your income and excess-profits tax liability, careful consideration has been given to the report of examination dated May 25, 1938, to your protests dated August 18, 1938 and December 2, 1938; to the statements made at the conferences held on November 1, 1938, January 11, 1939 and May 24, 1939.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form of waiver, inserting therein the amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by line 27, page No. 2 of return	\$ 85,288.67
Unallowable deductions and additional income	
(a) Gain on sales increased.....	\$119,705.58
(b) Adjustment capital stock tax.....	84.00
	119,789.58
Net income adjusted.....	\$205,078.25
	[11]

EXPLANATION OF ADJUSTMENTS

(a) Gain on sale as adjusted.....	\$212,040.32
Gain on sale as reported.....	92,334.74
Gain on sale increased.....	\$119,705.58

It is held that the profit realized from the sale of the busses and franchise to East Bay Railways, Ltd., is \$212,040.32 under the provisions of section 111(a) of the Revenue Act of 1936 and that there is no authority under the provisions of section 113(b) of the Revenue Act of 1936 to capitalize as the cost of the franchise the operating losses of the years 1931 to 1935, inclusive.

(b) It is held that the correct amount to be deducted for capital stock tax is the amount of \$916.00 and that the deductions claimed in excess of that amount, viz., \$84.00, are not deductible under the provisions of section 23(c) of the Revenue Act of 1936.

COMPUTATION OF TAX

Excess-profits Tax:

Taxable net income.....	\$205,078.25
-------------------------	--------------

Less:

10% of \$1,000,000.00 value of capital stock as declared in your capital stock tax return for the year ended June 30, 1936.....	100,000.00
---	------------

Net income subject to excess-profits Tax.....	\$105,078.25
---	--------------

5% of declared value of capital stock.....	50,000.00
--	-----------

Balance	\$ 55,078.25
---------------	--------------

Excess-profits tax:

6% of \$50,000.00.....	\$ 3,000.00
12% of \$55,078.25.....	6,609.39

Total excess-profits tax.....	\$ 9,609.39
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Excess-profits tax assessed:

Original First California, account No. 402625.....	none
--	------

Deficiency of excess-profits tax.....	\$ 9,609.39
---------------------------------------	-------------

[12]

Income Tax:

Normal Tax:

Taxable net income.....	\$205,078.25
-------------------------	--------------

Less:

Excess-profits tax	9,609.39
--------------------------	----------

Net income for normal tax computation.....	\$195,468.86
--	--------------

8% of \$ 2,000.00 (Over 0 to \$ 2,000).....	160.00
11% of 13,000.00 (Over 2,000 to 15,000).....	1,430.00
13% of 25,000.00 (Over 15,000 to 40,000).....	3,250.00
15% of 155,468.86 (Over 40,000).....	23,320.33

Total normal tax.....	\$ 28,160.33
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Surtax on Undistributed Profits:

Taxable net income.....	\$205,078.25
-------------------------	--------------

Computation of Tax (Cont.)

Less:

Excess-profits tax	\$ 9,609.39	
Normal tax	28,160.33	37,769.72

Adjusted net income.....\$167,308.53

Less:

Dividends paid credit.....	101,000.00	
----------------------------	------------	--

Undistributed net income.....\$ 66,308.53

Less:

Specific credit	none	
-----------------------	------	--

Remainder subject to surtax.....\$ 66,308.53

7% of \$16,730.85.....\$ 1,171.16

12% of \$16,730.85.....2,007.70

17% of \$32,846.83.....5,583.96

Normal surtax \$ 8,762.82 | |

Normal tax 28,160.33 | |

Total income tax (normal tax and surtax).....\$ 36,923.15

Income tax assessed (normal tax and surtax):

Original First California, account No. 402625..... 11,633.30

Deficiency of income tax.....\$ 25,289.85

[13]

EXHIBIT "B"

Agreement

This Agreement, Made this 14th day of January, 1936, by and between Peerless Stages, Inc., a corporation, sometimes hereinafter referred to as "Peerless", and Railway Equipment & Realty Company, Ltd., a corporation, sometimes hereinafter referred to as "Equipment Company",

Witnesseth:

Whereas, Peerless owns and operates a system of motor coach lines and is the holder of certain operative rights, and particularly certain local motor coach lines and operative rights in the County of Alameda, as hereinafter described, and is the owner of certain equipment used in the operation of said service; and

Whereas, East Bay Street Railways, Ltd., a corporation, sometimes hereinafter referred to as "Street Railways", owns and operates a system of street railway and motor coach lines in the Counties of Alameda and Contra Costa, including certain motor coach and street railway lines between the Cities of Oakland, San Leandro and Hayward; and

Whereas, Equipment Company owns the operating equipment leased to and used by Street Railways in said service, and is the owner of all the shares of the capital stock of Street Railways; and

Whereas, Peerless is agreeable to abandoning certain of its motor catch lines and certain of its operative rights upon the performance of all the terms and conditions hereinafter set forth, and desires to sell certain equipment; and

Whereas, Equipment Company desires to purchase said equipment; and

Whereas, the parties hereto have been informed that Street Railways desires to operate a motor coach service over the routes to be abandoned by Peerless and will file an application with the Rail-

road Commission of the State of California for a certificate of public convenience and necessity to operate the same;

Now, therefore, it is hereby agreed by and between the parties hereto as follows:

1. Peerless agrees to abandon all local service ("local service" is herein defined to mean the carrying of passengers between any two points, both original and destination being within the territory described in Exhibit B) and such motor coach routes as are engaged wholly in local service, whether operated by virtue of certificates of public convenience and necessity or by reason of operative rights acquired prior to regulation by the Railroad Commission of the State of California or by permits or franchises from any political subdivision or otherwise, and to discontinue local service on through equipment, said local service and routes being more particularly described in Exhibit A attached hereto and made a part hereof. [14]

Peerless further agrees not to file any tariffs for, engage in, conduct or operate directly or indirectly for itself or its successors or assigns, any local service whatsoever for the transportation of passengers for hire within the territory designated on the map marked "Exhibit B" attached hereto and made a part hereof.

Nothing herein contained is intended to apply to the transportation of express matter or mail nor to charter, contract, freight or taxi service.

2. Peerless agrees to sell, and Equipment Company agrees to buy, fifteen (15) thirty-seven pas-

senger motor coaches no longer required in the public service by Peerless, said motor coaches being more particularly described in Exhibit C attached hereto and made a part hereof.

3. Equipment Company agrees to pay to Peerless the sum of One Hundred Eighty Thousand Dollars (\$180,000.00), and to further pay to Peerless an additional sum of Thirty Thousand Dollars (\$30,000.00), which said last mentioned sum is to be paid to Peerless as reimbursement on Peerless' local service operating deficit for the period from April 1, 1935 to December 31, 1935; also to pay to Peerless an additional sum equal to the local service operating deficit of Peerless from January 1, 1936 to the date of actual abandonment of local service by Peerless as authorized by orders of the Railroad Commission of the State of California, and granting a certificate or certificates of public convenience and necessity to Street Railways to operate local service, as hereinafter provided. The operating deficit last referred to shall be based upon an agreed operating expense of twenty cents (20¢) per coach mile; mileage to be computed on route trip miles as set forth in Exhibit A.

The payments to be made by Equipment Company to Peerless shall be made in the following manner:

(a) Upon the execution of this agreement, One Hundred Thousand Dollars (\$100,000.00) shall be deposited in escrow with Wells Fargo Bank and Union Trust Co., San Francisco, California, and

shall be paid to Peerless upon presentation to said bank of the following documents:

1. Copy of order of the Railroad Commission of the State of California authorizing the abandonment of local service by Peerless, as described in Exhibit A attached hereto, certified by the Railroad Commission as a true copy.

2. Copy of the acceptance of Peerless of the abandonment order filed with the Railroad Commission, certified by the Railroad Commission as a true copy.

3. Copy of the Railroad Commission's order granting to Street Railways a certificate of public convenience and necessity to operate the service described in Exhibit E attached hereto, certified by the Railroad Commission as a true copy. [15]

4. A bill of sale covering the fifteen (15) motor coaches described in Exhibit C attached hereto, together with duly enclosed certificates of registration therefor.

(b) One Hundred Ten Thousand Dollars (\$110,000.00) and the total of the deficit from January 1, 1936 to date of abandonment by Peerless and the commencement of operation by Street Railways, as herein provided, shall be paid to Peerless ninety (90) days after the payment of said One Hundred Thousand Dollars (\$100,000.00).

Equipment Company shall have the right to audit the books of Peerless to determine the operating deficit hereinbefore referred to.

4. Immediately upon the execution of this agreement, and concurrently with Street Railways, as hereinafter provided, Peerless shall file, or cause to be filed, with the Railroad Commission of the State of California an application for authority to abandon all local service as described in Exhibit A, said application to be in the form set forth in Exhibit D attached hereto and made a part hereof.

Equipment Company agrees to cause Street Railways to file with the Railroad Commission of the State of California, concurrently with Peerless as hereinbefore provided, an application for a certificate or certificates of public convenience and necessity to operate motor coach service over all the routes to be abandoned by Peerless, except those for which Street Railways now holds a certificate or certificates of public convenience and necessity, said application to be in the form of Exhibit E attached hereto and made a part hereof.

It is assumed by both parties hereto, and both parties hereto agree to request that the Railroad Commission will so make its orders on the application of Peerless and the application of Street Railways respectively, that it will be possible for Peerless to comply with the requirements of the order of the Railroad Commission, such as notice to the public, etc., and abandon local service at the close of one day and Street Railways commence service at the start of the next succeeding day. Peerless agrees to comply with the order of the Railroad Commission, when, as and if issued on Peerless' said application, as soon as possible under the requirements

of said order after said order is issued. Whenever in this agreement the words "the effective date of said Commission's orders", or similar words having the same meaning, appear, it is mutually agreed that the date referred to is the first date that Peerless may lawfully abandon service under the requirements of any order or orders of said Railroad Commission given on Peerless' said application.

5. Immediately upon the effective date of said orders of the Railroad Commission, Peerless agrees to withdraw its application now pending before the Railroad Commission of the State of California seeking an operative right on San Leandro Street, being Application No. 20326.

6. The fifteen (15) motor coaches to be sold by Peerless to Equipment Company shall be delivered to Equipment Company, or its nominee, and Equipment Company agrees to accept said motor coaches at either Oakland or Hayward, at the close of business on the date of said abandonment by Peerless. Said fifteen (15) motor coaches shall be delivered free and clear of all liens and encumbrances, and said purchase shall not be deemed an assumption by Equipment Company or Street Railways of any liability, indebtedness, obligation, claim, demand, action or cause of action of any nature whatsoever attached to, incidental to, or arising [16] out of, the ownership or operation of said equipment by Peerless; and Peerless hereby covenants and agrees to save harmless and indemnify Equipment Company and Street Railways, or either, from all, or

any, of said liabilities, obligations, claims, demands, actions or causes of action whatsoever.

7. In the event said motor coach service is abandoned by Peerless, as hereinbefore provided, and Street Railways, operates a motor coach service over said, or any of said routes, as hereinbefore provided, said operation by Street Railways shall not be deemed an assumption by Street Railways or Equipment Company, or any of their affiliated companies, or their successors or assigns, of any liability, indebtedness, obligations, claim, demand, action, or cause of action, of any nature whatsoever attached to, incidental to, or arising out of the sale or issue of any ticket, token, pass or other medium of fare, or the operation of any motor coach service by Peerless; and Peerless hereby covenants and agrees to save harmless and indemnify Equipment Company and Street Railways from all or any of said liabilities, obligations, claims, demands, actions or causes of action whatsoever.

8. In the event the Railroad Commission of the State of California should fail to make either of the orders hereinabove referred to, as prayed for, within sixty (60) days from the date heretof, this agreement shall become null and void.

9. This agreement is expressly made for the benefit of Street Railways.

10. This agreement shall be binding upon the parties hereto and upon their successors and assigns.

In witness whereof, said parties hereto have

caused this agreement to be executed in duplicate by its proper officers who are thereunto duly authorized.

PEERLESS STAGES, INC.

by JOS. B. HELD (Signed)

President

Attest:

G. J. WEISER (Signed)

Secretary

Peerless Stages, Inc.

(Seal)

RAILWAY EQUIPMENT &

REALTY CO., LTD.

by A. LUNDBERG (Signed)

Attest:

ANGUS CLARK (Signed)

Secretary [17]

Railway Equipment &

Realty Company, Ltd.

(Seal)

EXHIBIT "C"

PASSENGER & EXPRESS REVENUES AND MILEAGE—BY YEARS

Years 1931 to 1935 Inclusive

Year	Passenger and Express Revenues	Annual Mileage
(1) 1931	\$ 48,356.91	282,127
1932	58,230.04	328,860
1933	63,355.05	342,513
(2) 1934	101,640.22	753,967
1935	108,550.72	839,046

(1) Development undertaken through addition of local service

and busses along E. 14th St. route.

- (2) Additional development undertaken through addition of local service and busses along San Lorenzo and Castro Valley routes.

[Endorsed]: U.S.B.T.A. Filed Oct. 25, 1939. [18]

[Title of Board and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) to (d), inclusive. Denies that the determination of tax set forth in the said notice of deficiency is based upon errors as alleged in subparagraphs (a) to (d), inclusive, of paragraph 4 of the petition. [19]

5. (a) Admits that the petitioner entered into an agreement with the Railway Equipment and Realty Company, Ltd., under date of January 14,

1936, under which petitioner was agreeable to abandoning certain of its motor coach lines and certain of its operative rights upon the performance of all the terms and conditions set forth in such agreement, and that petitioner reported as taxable income by virtue of said agreement in its corporation income and excess profits tax return for the calendar year 1936 a capital gain of \$92,334.74. Denies the remaining allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) Admits that a revenue agent of the Commissioner of Internal Revenue made a field examination of the petitioner's books and accounts for the calendar year 1935. Denies the remaining allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits the allegations contained in subparagraph (c) of paragraph 5 of the petition.

(d) to (h), inclusive. Denies the allegation contained in subparagraphs (d) to (h), inclusive, of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied. [20]

Wherefore, it is prayed that the Commissioner's determination be approved and that the petitioner's appeal be denied.

[Signed] J. P. WENCHEL

TMM

J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

HARRY R. HORROW,

Special Attorneys,

Bureau of Internal Revenue.

HRH/vg 12/6/39

[Endorsed]: U. S. B. T. A. Filed. Dec. 12, 1939

[21]

United States Post Office and Court House,

San Francisco, California,

October 10, 1940. 10:55 a. m.

Before: Hon. John M. Sternhagen.

Met pursuant to notice.

Appearances:

Clyde C. Sherwood and John V. Lewis, 333 Montgomery Street, San Francisco, California, appearing for Peerless Stages, Inc., Petitioner.

T. M. Mather, appearing for the Commissioner of Internal Revenue, Respondent. [23]

Proceedings

The Member: Docket No. 100436, Peerless Stages, Inc. Who appears for the petitioner?

Mr. Sherwood: Ready for the petitioner. Clyde C. Sherwood and John V. Lewis appearing for the petitioner.

The Member: You are Mr. Sherwood?

Mr. Sherwood: I am Mr. Sherwood, and this is Mr. Lewis (indicating).

The Member: And for the respondent?

Mr. Mather: T. M. Mather.

The Member: Proceed, sir.

Statement of Case on Behalf of Petitioner.

Mr. Sherwood: The issue in this case, your Honor, is one that has been before the Board on two or three occasions in matters involving newspaper circulations, and particularly in the Houston Gas Company case. In other words, the question is whether money expended for a development constitutes ordinary losses to be deducted in the taxable year in which they were expended, or whether they are to be capitalized as capital investments. But in this particular case the petitioner prior to 1931 was operating a bus line, a commercial bus service between Oakland, California, San Jose, and Santa Cruz.

The Member: Is that the year in question, 1931?

Mr. Sherwood: No. The year in question, your Honor, is 1936, and the question is whether the losses sustained in 1931, 1932, 1933, 1934 and 1935

[25]

are to be considered deductible losses in those respective years, or whether they are to be considered as capital investments, because in 1936 the company sold out this particular development and realized thereon a considerable sum of money, in fact, about twice as much as we are attempting to capitalize as an investment.

The Member: What am I to understand you mean by "development"; this particular development?

Mr. Sherwood: I was going to explain that, your Honor; prior to 1931 they operated a regular bus line which stopped at some principal cities between Oakland, San Jose and Santa Cruz. Commencing in 1931 the company commenced to operate a local bus service with a 20-minute headway in the metropolitan East Bay area, which means from Oakland, Fruitvale, San Leandro and Hayward. Prior to that time the buses had stopped at Hayward and San Leandro and Oakland, but there was no intermediate service between those points, which is about 15 miles which at the time was built up pretty well along the highway that the buses traveled, but there were some intervening fields and places where new subdivisions were about to be opened.

The company's theory was that in 1931 the bus service could not pay its way, and that they could put on a service which could pay its way by operating buses at infrequent intervals. The company decided to put on a service which [26] would be sufficient to attract new settlers in those communities, and to build up a valuable right. So they went to the Railroad Commission, which is the regulatory body in this state for all public utilities, received a permissive right to operate this local bus line. It was not technically a franchise. It did not convey an exclusive right to that territory, but merely a permissive right to engage in automotive transport along a designated set of streets and highways.

In 1931 on this new development the——

The Member: (Interposing): It was a necessary permit before they could operate, and to that extent was a franchise?

Mr. Sherwood: I merely wanted to explain it was a franchise which was transferable or which was not exclusive. It was a permission to this company.

The Member: Without which they could not operate?

Mr. Sherwood: Without which they could not operate.

The Member: And I suppose by the same token, competitors might have had the opportunity and privilege to engage in the same operations?

Mr. Sherwood: And in fact, they did so. At the end of this period in 1935 this was done. I will explain that in just a moment.

In 1931 on this new development the company traveled 282,127 miles in addition to the routes which they had traversed before, and their revenues were \$48,356.91. [27]

In 1932 they traveled about 40-or 50,000 miles more, and their revenues were about \$10,000 more.

By 1933 they traveled 342,513 miles, and they practically broke even. The operation showed a loss of about \$500.00 for that period.

So that is what we call the first development. I am trying to make this clear because we have two separate developments involved in this procedure over five years.

So then the company went back to the Railroad Commission and got another permit to extend the bus lines to take in some rural towns, small towns with considerable pasture land and truck gardening, and so on, in between, outside the metropolitan area entirely, and these lines went to Alvarado and Castro Valley and way points.

At the proper time I will introduce a little map which shows the exact amounts of these developments.

The mileage then jumped up in 1934 from 342,513 in '33 to 753,697 miles in '34 and 839,046 miles in '35.

All these figures that I have given you are in addition to the regular run which they had operated between San Jose and Santa Cruz, and which they continue to operate to this day, and which is not involved in this controversy at all.

This new development in 1935 got the revenues up to \$108,550.72 and, we will show, showed a loss in the year 1935 on that mileage of \$52,885.41. [28]

In 1936 a competing line on a portion of this route bought out that portion of the Peerless Stages route which is covered by the two developments which I referred to as the "new developments," and they still retain their old original primary business.

The only controversy is over the disposition of that purchase price. The Commissioner has held that the losses sustained from '31 to '35 inclusive were ordinary business losses and deductible in the

years where sustained. The company contend that the money that was spent for the actual rendering of service on these routes was rendered deliberately, knowing that it would not pay in the particular years, but that it would develop a valuable route in the future, and we will show that actually when they sold out, the sales price was almost \$100,000 more than the amount that we are attempting to capitalize as the cost of this development. In other words, they spent \$119,705.58, which we have set up as the cost of developing this route which is arrived at by taking the losses for 1931, 1932, 1933, 1934 and 1935 on those particular routes.

The Member: There were no losses deducted in those years? The losses that you incurred were not deducted?

Mr. Sherwood: In some of them. The taxpayers in filing their returns for the first years, 1931, '32, '33, and '34 did deduct those losses. In 1935 when the largest loss [29] occurred, they did not deduct the losses, but showed them as a capital investment on their 1935 income tax return, and by the way, the Internal Revenue agent then audited those returns and approved them for 1935. Whereupon the company filed amended returns for 1931, 1932, 1933 and 1934 and paid to the Collector of Internal Revenue the additional tax that was due for all those years, except in one in which I believe there was nothing due, computed upon the basis of taking those losses which had been deducted out of the category of

losses and capitalizing them as capital investments. In other words, they increased their net gains for those years by those respective amounts. So that we do not have a completely clear picture either way. They did take the gains in the first instance for the first four years; then filed amended returns and canceled them out. And in 1935 the original return set up the \$52,000 as a capital investment.

There is one point——

The Member: (Interposing): Now, that is all closed; is it?

Mr. Sherwood: Yes.

The Member: As to 1931, for example?

Mr. Sherwood: What?

The Member: 1931, '2, '3, and '4, those years are closed; are they not?

Mr. Sherwood: The Government has the money for those [30] particular years. In order to protect the taxpayer from the possibility of the Commissioner's ruling being sustained here, claims for refund were filed with the proper authorities, and by an agreement being held in abeyance by the Commissioner pending the outcome of this litigation. So that in any event, the Government will get all the tax to which it would have been entitled either way the case is decided.

The Member: But those years are not closed? That is my question. None of those years is closed?

Mr. Sherwood: I meant that they were not involved in this case, but they are pending with the agent's office and he has allowed the refund claims

conditional upon this case being a loss. Of course, if this case is won by the petitioner, the refund claims will be denied.

The Member: He has allowed them, but he has not paid the money?

Mr. Sherwood: That's it. There is one item which might confuse your Honor in listening to the testimony which I think I should clear up in my opening statement.

There was a loss sustained of \$52,885.41 in 1935. When the purchaser of this line made the agreement to purchase in 1936, the agreement to purchase was signed in January in 1936, and in accordance with that agreement, the purchaser set up a price of \$189,000-odd, and then agreed to pay \$30,000-odd to compensate this company for its losses for a portion of its [31] losses sustained in operation in 1935. The bookkeeper of the company took this \$30,000 and set it up on the company's books as a credit against that capital investment of \$52,000 in 1935, but he also set it up as income for 1935. The investigating agent ruled that that was income for 1935, and I agree with him. I cannot see any way out of that, and I think that the agent's ruling was proper.

However, our petition alleges that the total capitalization for the five years was \$119,755. In other words, we are still contending on exactly the same figures, and the only difference is that we are just saying that that \$30,000-credit which was put on

the books by the bookkeeper was in error and should not be considered. It will have no effect upon the tax liability whatsoever because they did pay the tax on it in 1935.

So that the result will be, if the Court rules in this case, that the whole \$52,000 was a capital investment. They have already paid their 1935 tax on that particular item, and when they got that \$30,000 back in 1936 it would not be taxable. So that it simply simplifies the issue to the point where the only point before your Honor now is whether these five losses sustained in operation during those five years in developing these new routes are ordinary business losses or are investments which the petitioner was bound to capitalize. [32]

The Member: What did the petitioner sell in 1936?

Mr. Sherwood: He got permission from the Railroad Commission to assign that permissive right that he had to use those routes and his goodwill and the routes themselves. There were a few buses sold, which are not part of this purchase price. The purchase price was——

The Member (Interposing): There isn't any physical property in question here at all?

Mr. Sherwood: Not in this petition. The agreement segregated those, and the purchaser paid so much for some buses which the agent has passed and which is not involved here. Whatever problems of depreciation there may have been on the buses

was settled by the examining agent, and as far as I know, there is no controversy involving any taxable property in this case at all.

The Member: Now, what do you understand is the controversy in fact, if any? What factual controversy is there? Is there any dispute, for example, as to how much in each year the petitioner sustained as a loss, whether the \$119,000 is, in fact, the correct aggregate of the five years' losses; how much it got; what the comparative figures of what it got and what it paid are? Are any of those in controversy?

Mr. Sherwood: I have here a transcript from the books showing profit and loss statements for every year involved, and a summary. [33]

Now, I can show those to counsel, and if they are in accordance with the revenue agent's report, I suppose we will have no further controversy about them.

The Member: Well, I was just wondering whether the pleadings put all of those questions in issue, or whether they are admitted.

Mr. Sherwood: I think it would be very helpful in developing our written argument, your Honor, in any event, whether the pleadings meet them or not, to have the tables in evidence. I don't want to take a lot of your Honor's time, but I would like to have them in the record.

Some of the arguments based on the Houston Gas Company case are bound up in the figures, the way they are arrived at. I think there will be no

controversy as to the amounts involved here.

I will give counsel a copy of them and offer them when the witness is on the stand, if that is agreeable with your Honor.

The Member: Is that the end of your statement?

Mr. Sherwood: That is my statement, your Honor.

STATEMENT OF CASE ON BEHALF OF THE RESPONDENT.

Mr. Mather: If your Honor please, the petitioner in this case in 1936, in January, 1936, entered into agreement to dispose of its properties, including buses, franchise, and go out of business to a competing concern in the East [34] Bay for the contract, bill of sale provided what would take place, what was to be disposed of, and what price was to be paid.

I do not think there is any question with respect to the amount that was to be paid, what was disposed of.

The date is very important in this proceeding for this reason: Prior to the sale of these properties and prior to the filing of any returns, the petitioner had since 1931 and since its existence taken deductions of ordinary and necessary expenses as operating losses in its return, and it did in 1931, 1932, 1933 and 1934, but the sale being in January of 1936 when the return for 1935 was filed, apparently development expense occurred to the petitioner for

the first time. So amended returns were filed. The return for '35 set up development expense which was nothing but ordinary and necessary business expense of operation of that type of business, and filed amended returns for 1931, '2, '3 and '4 claiming a part of its ordinary and necessary business expense for operating this type of business as the development expense, and in filing its return for '36 claimed deduction of those expenditures which, for the first time in '36—excluding '35—and the return was filed in March of '36, the sale having occurred in January of '36—set up the development expense in the five returns for the first time.

Now, it is our position, if your Honor please——

[35]

The Member (Interposing): Well, there isn't any dispute about the date; is there?

Mr. Mather: The date of sale?

The Member: You said the date is very important. You simply mean that it is important. You do not mean there is an important controversy about that?

Mr. Mather: No. There is no dispute. It is a matter of record. There is a bill of sale——

The Member (Interposing): I misunderstood what you were intending to say.

Mr. Sherwood: I believe there is a copy of the contract of sale attached to our petition.

Mr. Mather: That is correct. Now, it is the position of the respondent that this petitioner acquired a franchise and was operating a transporta-

tion service prior to the incorporation, if you please, of this petitioner. And then the petitioner was incorporated in 1932 and continued to operate under that franchise—well, under the franchise from that time on.

Now, in 1931 it made additional stops in Oakland to pick up passengers, which it had a right to do under the original franchise. Nothing happened in 1931. They decided that there was some customers that they could pick up and make some money. So they made additional stops in '31 as they were permitted to do under their franchise. [36]

Now, in 1934 for the first time the corporation obtained a franchise to deviate from its direct route on East 14th Street and to alternate buses from Oakland through San Leandro via San Lorenzo to Hayward and from Oakland through some other places, and its expenses were the ordinary and necessary expenses of operating that service.

The Member: Make your case.

Mr. Sherwood: Mr. Weiser.

GEORGE J. WEISER

a witness on behalf of petitioner, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Sherwood) What is your name, please?

A. George J. Weiser, W-e-i-s-e-r.

Q. Where do you live? A. Oakland.

(Testimony of George J. Weiser.)

Q. Are you connected with the petitioner in this matter? A. I am.

Q. Will you state your official capacity, please?

A. I am secretary and auditor.

Q. When did you first become auditor for the petitioner? A. During 1923.

Q. When did you first become secretary?

A. During 1924.

Q. Have you been continuously both auditor and secretary [38] since 1924? A. I have.

Q. In general, what do your duties comprise?

A. I supervise the accounting of the organization. I handle the duties as secretary of the corporation, and in addition to that, I assist the president and general manager.

Q. What type of work do you do in assisting the president and general manager in addition to accounting work?

A. Occasional discussion of company policy with regard to operating problems.

Q. Who prepares the files, tax returns, for the company? A. I do.

Q. Have you, continuously during all the period from 1924? A. I have.

Q. Approximately when did this company first engage in the transportation business?

A. This company was incorporated in 1923. Prior to 1923 the operations of this company were conducted by several individuals who were operating as an association. I believe these individuals

(Testimony of George J. Weiser.)

engaged in business as early as 1915 or '16.

Q. From the date of incorporation on can you state what the route was that was traversed by the buses of this company?

A. The principal routes of this company consisted of inter-city operation between Oakland and San Jose, San Jose and [38] Santa Cruz, and between Oakland and Palo Alto.

Q. Did any change in the business of the company occur at the end of 1931 in regard to the service rendered?

A. Well, there were changes during 1931 that were instituted.

Q. You have in your hand a little map. Will you state what it is.

A. This map is entitled "Map of Bus Routes between Oakland and Hayward—Years 1931 to 1935, Inclusive."

Mr. Sherwood: Is there any objection to offering the map in evidence as an illustrative exhibit?

Mr. Mather: None whatever for that purpose.

Mr. Sherwood: I have several copies of it, your Honor. Possibly it will be convenient for you to have one in your hand (handing document to the Member).

I will offer this original, then, as the first exhibit.

The Member: That is received.

The Clerk: Exhibit 1.

(The said map so offered was received in evidence, and marked Petitioner's Exhibit No. 1 and made a part of this record.)

(Testimony of George J. Weiser.)

Q. (By Mr. Sherwood) Mr. Weiser, will you state what the route development in red on this map indicates?

A. The route development outlined in red, or, the route outlined in red indicates the development undertaken in the year 1931 between Oakland and Hayward. [39]

Q. Had the company's buses traversed that route before?

A. Yes, they had, as part of an inter-city service from Oakland to San Jose.

Q. Now, will you state specifically what changes in service were made in 1931 along the route which is depicted in red on the map?

A. Well, just prior to 1931 the company made a survey of the area, or the territory surrounding San Leandro and Hayward and realized that here was an area that was ripe for development. It consisted of a great deal of open land or orchard land and tomato land. Climatic conditions in the area were ideal, and it occurred to the company that inasmuch as lots and homesites could be purchased here for very small amounts, and in view of the fact that the area was so close to the city of Oakland, that this territory should really develop into quite a homesite area. And we found that the principal thing that kept development from occurring in this suburban area was the lack of adequate transportation facilities. In order for the area to develop we felt that it was necessary to make available a

(Testimony of George J. Weiser.)

fast and frequent and economical service between Oakland and Hayward so that anyone who might want to settle in the territory would be able to get to their work conveniently, and so that members of their families could get into Oakland for shopping, schools, and other business matters. [40]

We, of course, were very anxious to bring about this development in the shortest possible time, and we had the alternative of proceeding under two plans. The area at that time was very sparsely settled, and we could have put on a skeleton service in the area that we felt would have about broken even or sustained a slight loss. We felt that under this procedure the development of the area would not materialize nearly as rapidly as it would if we put into effect a service which was considerably in advance of the needs of the people who were then living in the area, feeling that that frequency of service would hasten the settlement of the community, attract additional people there in a much shorter period of time.

And so in 1931 we put on a purely local service between Oakland and Hayward, that is, buses originated in Hayward and terminated—or, originated in Oakland and terminated in Hayward.

Q. May I interrupt to ask you: Were these separate buses from the ones you were using on the through route?

A. The inter-city buses continued operation

(Testimony of George J. Weiser.)

through San Jose by way of San Leandro and Hayward, and this service was distinctly an additional, new service for the area. The previous service was merely a casual service on inter-city buses, whereas these were local cars operating between Oakland and Hayward only. [41]

Q. Ah what frequency did they operate?

A. We established a 20-minute frequency in that area in 1931.

Q. At what points would these buses stop on this local run?

A. They would stop at all corners for pickup and all corners for discharge of passengers.

Q. I interrupted you. Is there anything further about the additional development here that you have not told us?

A. Not so far as the year 1931 is concerned.

Q. In the lower right-hand corner of the map there are some statistics as to the miles traveled and the receipts for the particular years.

Were those figures compiled by you?

A. They were.

Q. Did they come from the books of the company?

A. They did.

Q. And are they correct?

A. I believe them to be.

Q. Did the business develop along this route to the point where the development was paying its own way?

(Testimony of George J. Weiser.)

A. Yes. This statistical table on this map of bus routes shows that in 1931 there were 282,000 miles of service rendered by the local buses between Oakland and Hayward and our receipts during the first year of development were \$48,356.91. During the next year, 1932, there was some [42] increase in mileage, that figure going to 328,860, and our receipts improved over the first year of development, the 1932 receipts amounting to \$58,230.04.

In 1933 these receipts improved further to \$63,355.05, and of course the mileage had increased likewise to 342,513.

I might state that right on the heels of the institution of this local service, development or settlement of the area proceeded quite rapidly. It seemed to be the lack of suitable transportation heretofore. That seemed to be the one thing which had held the community back.

Q. Can you state what the actual operating loss was in the year 1933?

A. In the year 1933 the actual loss sustained on the Oakland-Hayward local line was \$516.47, whereas during the first year of development, 1931, the loss was \$15,613.54.

Q. Now, referring to the route which is traced in green upon the map, will you state what that indicates?

A. Well, that indicates the San Lorenzo and Castro Valley area that was serviced commencing with 1934.

(Testimony of George J. Weiser.)

I should like to explain that a little further, if I may.

Q. Just a moment. I will ask you a general question on that. Will you state the steps taken by the company to obtain permission for that extension and what the company did pursuant to that permission? [43]

A. Well, during the latter part of 1933 we checked this area in detail further, and we found that the area immediately north and south of our East 14th Street route was likewise in the same position as the East 14th Street route, that is, we had an ideal setup there for settlement of the community. But the difficulty again was lack of suitable transportation.

Q. I might interrupt you to ask you if there was a decided difference in the intensity of the population between this area and the first one developed.

A. During what—comparing them in what periods?

Q. Let me withdraw that. I don't think the question is intelligible.

Was the population more sparse in this area, that covered by the development shown by the green line, than it had been in the area covered by the first development in 1931?

A. I think generally they were somewhat the same. I don't exactly recall. Both areas were sparsely settled at the time the development com-

(Testimony of George J. Weiser.)

menced, but during 1934 the development along the East 14th Street route, the settlement along the East 14th Street route was considerably more than it was in these outlying territories of San Lorenzo and Castro Valley in which service had not as yet been instituted.

During the latter part of 1933 we filed application with the State Railroad Commission for authority to serve the San Lorenzo and Castro Valley areas. That authority was granted [44] to us, and in 1934 we instituted an additional local service between Oakland and Hayward by way of Castro Valley and San Lorenzo. This likewise operated on an approximate 20-minute frequency, and this service was coordinated with the existing local service along the East 14th Street route, and over all it gave effect to about a 10-minute headway between Oakland and Hayward.

Q. If I understand you then, it gave a 20-minute headway on the new territories covered, but the fact that the same buses went back through East 14th to Oakland reduced the headway on that street to about 10 minutes?

A. On parts of East 14th Street in the area lying between the east city limits of Hayward and A Street in Hayward, which is shown on the map here, and between San Leandro and Oakland the coordination of this service provided a 10-minute frequency. However, to the people who were along the East 14th Street route lying between San Le-

(Testimony of George J. Weiser.)

andro and A Street in Hayward, they only had this 20-minute frequency available, and the other 20-minute frequency was available to the Castro Valley and San Leandro residents.

Q. Can you state the losses sustained in the operation of the development in 1934 and 1935?

A. As to the losses in the operation in 1934, \$39,459.22. And the 1935 loss was \$52,885.41.

Q. Mr. Weiser, I asked you to prepare from your records a [45] statement of profit and loss for the petitioner for the years 1931 to 1935, inclusive. Have you that statement?

A. I have.

Q. You have also a summary page showing the losses for all five years?

A. All five years, so far as they apply to the Oakland-Hayward operation.

Mr. Sherwood: Your Honor, I have here the profit and loss statement of the company for each of the years in question, together with the summary which—except insofar as these controversies, as these issues are in controversy that I outlined—agrees with the Revenue Agent's report. And I would like to have them admitted as exhibit next in order.

Mr. Mather: May I ask your witness a couple of questions?

Mr. Sherwood: Yes, certainly.

(Testimony of George J. Weiser.)

Voir Dire Examination

Q. (By Mr. Mather) Do these documents to which Mr. Sherwood refers, rather, are they substantially the same as shown on your income tax returns for those years? A. They are.

Q. And you had these prepared from the books?

A. They were prepared from the books of our company.

Mr. Mather: Subject to check, if your Honor please, I have no objection. [46]

The Member: Very well. They may be received.

Mr. Sherwood: I am offering the profit and loss statement for the year 1931.

The Clerk: Exhibit 2.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 2 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 2

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1931

Page 1

	Total All Divisions	Oakland-Hayward Division
Transportation Revenues		
Passenger Revenues.....	\$237,416.87	\$ 47,665.36
Express Revenue.....	8,736.93	691.55
Other Transportation Revenues		
Special Trips.....	15,569.04	
Concession & Check stand.....	5,669.78	
Commissions, etc.	3,585.83	
Total Transportation Revenues.....	<u>\$270,978.46</u>	<u>\$ 48,356.91</u>
Transportation Expenses		
Conducting Transportation		
Drivers wages.....	\$ 44,304.01	\$ 11,735.91
Gasoline.....	25,987.40	6,218.53
Oil.....	2,507.52	608.60
Service Car Expenses.....	77.51	18.35
Station Salaries.....	10,756.32	2,090.40
Station Expenses.....	9,033.05	934.63
Damaged Baggage.....	1.25	—
Shop Expenses.....	19,535.96	5,435.29
Misc. Transportation Expense.....	4,119.83	207.63
Total Conducting Transp.....	<u>\$116,322.85</u>	<u>\$ 27,247.34</u>
Maintenance		
Equipment.....	\$ 41,189.39	\$ 9,826.77
Depreciation.....	57,596.65	13,749.28
Total Maintenance.....	<u>\$ 98,786.04</u>	<u>\$ 23,576.05</u>
Traffic		
Superintendence.....	\$ 5,844.34	\$ 1,435.04
Advertising.....	3,824.98	858.96
Misc. Traffic Expense.....	18.50	4.51
Total Traffic.....	<u>\$ 9,687.82</u>	<u>\$ 2,298.51</u>
General Miscellaneous		
Sals. & Exp. General Officers.....	\$ 11,257.16	\$ 2,688.09
Sals. & Exp. Gen. Office Clerks.....	6,636.11	1,585.68
Office Supplies & Expenses.....	1,862.08	445.13
Stationery & Printing.....	3,741.75	977.93
Insurance Cost.....	10,616.49	2,517.19
Injuries & Damages.....	17,029.50	3,449.67
Legal Expense.....	1,750.80	432.67
Taxes & Licenses.....	11,502.65	2,071.23
Misc. Gen'l. Expense.....	5,770.12	95.88
Total General & Misc.....	<u>\$ 70,166.66</u>	<u>\$ 14,263.47</u>
Total Transportation Expenses.....	<u>\$294,963.37</u>	<u>\$ 67,385.37</u>
Net Operating Loss.....	<u>\$ 23,984.92*</u>	<u>\$ 19,028.46*</u>
[94]		
Page 2		
	Total All Divisions	Oakland-Hayward Division
Net Operating Loss (Forward).....	\$ 23,984.92*	\$ 19,028.46*
Non-Operating Income		
Other Income.....	5,205.71	
Net Income.....	<u>\$ 18,779.21*</u>	
Non-Operating Expenses		
Other Interest.....	\$ 3,612.32	
Misc. Income Charges.....	3,689.19	
Total Non-Oper. Expenses.....	<u>7,301.51</u>	
Net Loss per Books.....	<u>\$ 28,080.72*</u>	<u>\$ 19,028.46*</u>
Adjustments for Income Tax Purposes		
Self Insurance Charges.....	\$ 14,307.53	\$ 3,414.92
Add. 1930 Inc. Tax Adjustment.....	4.95	—
Adjusted Net Loss.....	<u>\$ 11,768.24*</u>	<u>\$ 15,613.54*</u>

*Loss.

[Endorsed]: Petitioner's Exhibit No. 2. Admitted
in evidence Oct. 10, 1940. [95]

(Testimony of George J. Weiser)

Mr. Sherwood: The profit and loss statement for 1932.

The Clerk: Exhibit 3.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 3 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 3

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1932

Page 1

	Total All Divisions	Oakland-Hayward Division
Transportation Revenues		
Passenger Revenues	\$216,968.30	\$ 57,513.24
Express Revenue	7,311.92	716.80
Other Transportation Revenues		
Special Trips	11,825.45	
Concession & Check Stand	5,125.44	
Commission, etc.	3,185.85	
Total Transportation Revenues.....	\$244,416.96	\$ 58,230.04
Transportation Expenses		
Conducting Transportation		
Drivers Wages	\$ 37,452.15	\$ 11,063.47
Gasoline	37,335.73	10,529.81
Oil	2,409.97	662.37
Service Car Expense.....	60.72	17.10
Station Salaries	9,758.00	2,369.68
Station Expenses	8,080.26	917.14
Damaged Baggage	18.75	
Shop Expenses	14,147.18	4,007.17
Misc. Transp. Exp.	3,567.88	157.34
Total Conducting Transportation.....	\$112,830.64	\$ 29,724.08
Maintenance		
Equipment	\$ 28,496.24	\$ 8,049.42
Depreciation	59,625.11	16,757.50
Total Maintenance	\$ 88,121.35	\$ 24,806.92
Traffic		
Superintendence	\$ 3,783.95	\$ 1,089.68
Advertising	2,173.24	550.49
Misc. Traffic Expense.....	36.95	10.47
Total Traffic	\$ 5,994.14	\$ 1,650.64
General Miscellaneous		
Sals. & Exp. Gen'l. Officers.....	\$ 10,440.94	\$ 2,934.77
Sals. & Exp. Gen'l. Office Clerks.....	5,691.52	1,590.07
Office Supplies & Exp.	1,482.95	415.86
Stationery & Printing	3,923.62	1,184.57
Insurance Cost	7,647.30	2,141.64
Injuries & Damages	17,000.29	4,735.40
Legal Expense	1,642.31	477.46
Taxes & Licenses	10,269.83	2,491.34
Misc. Gen'l. Expense.....	4,934.65	39.83
Total General & Misc.	\$ 63,033.41	\$ 16,010.94
Total Transportation Expenses.....	\$269,979.54	\$ 72,192.58
Net Operating Loss	\$ 25,562.58*	\$ 13,962.54*
Net Operating Income		
Other Income	3,515.12	
Net Income	\$ 22,047.46*	
Non-Operating Expenses		
Other Interest	\$ 5,791.24	
Misc. Income Charges.....	1,509.87	
Total Non-Oper. Expenses.....	7,301.11	
Net Loss per Books.....	\$ 29,348.57*	\$ 13,962.54*
Adjustments for Income Tax Purposes		
Self Insurance Charges.....	9,715.46	2,731.60
Adjusted Net Loss	\$ 19,633.11*	\$ 11,230.94*

*Loss.

[Endorsed]: Petitioner's Exhibit 3. Admitted in evidence Oct. 10, 1940. [97]

(Testimony of George J. Weiser.)

Mr. Sherwood: 1933.

The Clerk: Exhibit 4.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 4 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 4

Peerless Stages, Inc.
STATEMENT OF PROFIT AND LOSS FOR YEAR 1933

Page 1

	Total All Divisions	Oakland-Hayward Division
Transportation Revenues		
Passenger Revenue	\$208,427.18	\$ 62,788.75
Express Revenue	5,656.27	566.30
Other Transportation Revenues		
Special Trips	12,315.23	
Commissions, etc.	1,697.68	
Total Transp. Revenues	<u>\$228,096.36</u>	<u>\$ 63,355.05</u>
Transportation Expenses		
Conducting Transportation	\$ 35,944.91	\$ 11,524.90
Drivers Wages	38,308.99	11,715.33
Gasoline	817.37	256.63
Oil	23.91	7.27
Service Car Expenses	8,616.15	2,216.17
Station Salaries	7,171.10	845.83
Station Expenses	12,578.66	3,889.78
Shop Expenses	2,684.17	146.35
Misc. Transp. Exp.	\$106,145.26	\$ 30,602.26
Total Conducting Transp.		
Maintenance		
Equipment	\$ 23,234.87	\$ 7,038.65
Depreciation	54,961.40	16,768.72
Total Maintenance	<u>\$ 78,196.27</u>	<u>\$ 23,807.37</u>
Traffic		
Superintendence	\$ 3,431.37	\$ 1,084.63
Advertising	3,678.96	1,189.72
Misc. Traffic Expense	67.80	22.40
Total Traffic	<u>\$ 7,179.13</u>	<u>\$ 2,296.75</u>
General Miscellaneous		
Sals. & Exp. General Officers	\$ 9,598.62	\$ 2,915.64
Sals. & Exp. Gen. Office Clerks	4,732.32	1,451.57
Office Supplies & Exp.	1,233.56	382.29
Stationery & Printing	2,994.80	950.93
Insurance Cost	4,469.11	1,325.62
Injuries & Damages	15,272.91	4,628.59
Legal Expense	1,240.91	372.81
Taxes & Licenses	9,800.71	2,740.26
Misc. Gen'l. Exp.	255.34	83.60
Total General Expense	<u>\$ 49,598.28</u>	<u>\$ 14,851.31</u>
Total Transportation Expenses	<u>\$241,118.94</u>	<u>\$ 71,557.69</u>
Net Operating Loss	<u>\$ 13,022.58*</u>	<u>\$ 8,202.64*</u>
[98]		
Net Operating Loss (Forward)		
Non-Operating Income		
Other Income	62,003.82	\$ 8,202.64*
Net Income		
Non-Operating Expenses	\$ 48,981.24	
Other Interest		
Misc. Income Chgs.	4,092.75	
Total Non-Oper. Expenses	<u>65,494.53</u>	
Net Profit per Books	\$ 42,481.71	\$ 8,202.64*
Adjustments for Income Tax Purposes		
Add: Self Insurance Charges	\$ 6,124.74	\$ 1,873.01
Depreciation Adjustment	19,009.05	5,813.16
Totals	<u>\$ 67,565.50</u>	<u>\$ 7,686.17</u>
Less: Transfer of Insur. Reserves	50,344.52	\$ 516.47*
Adjusted Net Profit	<u>\$ 17,220.98</u>	<u>\$ 516.47*</u>

*Loss.

[Endorsed]: Petitioner's Exhibit 4. Admitted in
evidence Oct. 10, 1941 [99]

(Testimony of George J. Weiser.)

Mr. Sherwood. 1934.

The Clerk: Exhibit 5.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 5 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 5

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1934

Page 1

	Total All Divisions	Outland-Flavored Divisions
Operating Revenues		\$100,974.22
Passenger Revenues	\$255,408.80	
Charter Trips	18,137.87	
Express Revenue	5,747.89	666.00
Mail Revenue	110.09	
Concession Rental	1,593.99	
Total Operating Revenues	<u>\$280,998.64</u>	<u>\$101,640.22</u>
Operating Expenses		
Maintenance & Garage Expense		
Parts & Outside Repairs	\$ 24,402.01	\$ 12,231.61
Repair Labor	18,937.84	9,430.94
Greasing, Washing, Storage	6,532.87	3,083.51
Tire Cost	9,644.53	4,716.52
Garage Super.—Sals. & Exp.	2,836.31	1,446.73
Light, Heat, Water, Power	1,237.23	624.24
Misc. Shop Exp.	3,843.77	1,979.02
Total Maintenance & Garage Exp.	<u>\$ 67,434.56</u>	<u>\$ 33,512.17</u>
Transportation Expenses		
Super. of Transp.—Sals. & Exp.	\$ 2,715.75	\$ 1,392.89
Drivers Wages & Bonuses	51,440.20	24,121.84
Gasoline—Busses	39,124.49	19,100.93
Oil—Busses	677.42	341.54
Bus Supplies	653.69	304.20
Other Transp. Exp.	642.28	305.11
Total Transp. Exp.	<u>\$ 95,253.83</u>	<u>\$ 45,566.51</u>
Station Expense		
Company Stations—Sals.	\$ 6,464.75	\$ 3,242.11
Company Stations—Other Exp.	848.55	406.02
Comm. Station Expense	1,124.77	568.81
Total Station Expense	<u>\$ 8,438.07</u>	<u>\$ 4,216.94</u>
Traffic Promotion & Adv.		
Salaries & Expenses	\$ 3,788.66	\$ 1,901.30
Tkts.—Baggage Chks., etc.	1,355.76	664.87
Tariffs & Schedules	845.64	431.74
Advertising	1,250.75	597.32
Total Traffic Promotion & Adv.	<u>\$ 7,240.81</u>	<u>\$ 3,595.23</u>
Insurance & Safety Exp.		
Workmen's Compensation	\$ 1,043.23	\$ 504.39
Public Liab. & Prop'ty. Damage	21,090.80	10,328.18
Fire & Theft Insurance	1,109.27	530.60
General Insurance	4,130.94	2,001.21
Total Ins. & Safety Exp.	<u>\$ 27,374.24</u>	<u>\$ 13,364.38</u>
Carried Forward	<u>\$205,741.51</u>	<u>\$100,255.23</u>

Peerless Stages, Inc.
STATEMENT OF PROFIT AND LOSS FOR YEAR 1934

Page 2

	Total All Divisions	Oakland-Hayward Division
Operating Expenses (Brought Forward).....	\$205,741.51	\$100,255.23
Administration Expenses		
Gen'l. Officers Sals. & Exp.....	\$ 9,774.74	\$ 4,413.74
Gen'l. Office Clerks Sals. & Exp.....	6,371.50	3,105.32
Stationery, Prtg. & Supplies.....	2,566.34	1,233.19
Misc. Gen'l. Office Exp.....	340.82	166.08
Telephone & Telegraph.....	1,407.41	683.78
General Legal Expense.....	1,953.92	960.55
Misc. Expense.....	777.94	370.82
Total Admin. Expenses.....	\$ 23,192.67	\$ 10,933.48
Total Operating Expense.....	\$228,934.18	\$111,188.71
Operating Taxes, Rents & Depr.		
Operating Taxes		
Gasoline Taxes.....	\$ 12,340.18	\$ 6,042.66
Public Utility Taxes.....	12,019.96	4,330.78
Other Licenses.....	25.00	12.75
Real Estate Taxes.....	6.27	3.25
Federal Capital Stock Taxes.....	150.00	77.55
Federal Excise Taxes.....	5,211.76	2,542.16
Total Operating Taxes.....	\$ 29,753.17	\$ 13,009.15
Operating Rents		
Shop Rents.....	\$ 2,700.00	\$ 1,308.60
Terminals & Stations.....	292.50	142.44
Office Rents.....	780.00	378.01
Joint Facilities Rents.....	4,200.00	2,035.60
Total Operating Rents.....	\$ 7,972.50	\$ 3,864.65
Depreciation & Retirements		
Depreciation of Busses.....	\$ 50,652.67	\$ 24,613.03
Depreciation Other Property.....	5,441.59	2,618.67
Total Depr. & Retirements.....	\$ 56,094.26	\$ 27,231.70
Total Oper. Taxes, Rents & Depr.	93,819.93	44,105.50
Total Operating Costs.....	\$322,754.11	\$155,294.21
Net Operating Loss.....	\$ 41,755.47*	\$ 53,653.99*
Other Income		
Non Operating Prop'ty. Rentals.....	\$ 952.00	
Profit or Loss from Disposal of Ppty.....	175.00	
Total Other Income.....	1,127.00	
Other Deductions		
Misc. Inc. Chgs.....	\$ 40,628.47*	
Interest Paid.....	12.36	
Non-Oper. Prop'ty. Taxes, Exp.....	3,410.93	
Total Other Deductions.....	4,535.83	
Net Loss per Books.....	\$ 45,164.30*	\$ 53,653.99*
[101]		
Page 3		
	Total All Divisions	Oakland-Hayward Division
Net Loss per Books (Forward).....		
Adjustments for Income Tax Purposes.....	\$ 45,164.30*	\$ 53,653.99*
Self Insurance Charges.....		\$ 3,581.48
Depreciation Adjustment.....	7,327.09	10,613.29
Miscellaneous.....	20,646.81	
Miscellaneous.....	167.00	14,194.77
Adjusted Net Loss.....	28,140.90	
Adjusted Net Loss.....	\$ 17,023.40*	\$ 39,459.22*

*Loss.

[Endorsed]: Petitioner's Exhibit No. 5. Admitted
in evidence Oct. 15, 1940. [102]

(Testimony of George J. Weiser.)

Mr. Sherwood: 1935.

The Clerk: Exhibit 6.

(The said statement so offered and received in evidence was marked Petitioner's Exhibit No. 6 and made a part of this record.) [47]

(Testimony of George J. Weiser.)

PETITIONER'S EXHIBIT NO. 6

Peerless Stages, Inc.

STATEMENT OF PROFIT AND LOSS FOR YEAR 1935

Page 1

	Total All Divisions	Outstanding Forward Dividend
Operating Revenues		
Passenger Revenues	\$269,953.24	\$107,763.07
Charter Trip Revenues	16,138.55	
Express Revenue	5,984.35	787.65
Misc. Comm., Etc.	1,378.41	
Concession Rentals	360.00	
Total Operating Revenues	\$293,814.55	\$108,550.72
Operating Expenses		
Maintenance & Garage Expense		
Parts & Outside Repairs	\$ 21,563.02	\$ 11,082.79
Repair Labor	18,611.31	9,565.70
Greasing, Washing & Storage	7,339.21	3,772.15
Tire Cost	12,685.73	6,520.11
Garage Super.—Sals. & Exp.	3,385.39	1,740.00
Light, Heat, Water & Power	1,373.86	706.13
Misc. Shop Exp.	3,697.97	1,900.65
Total Maintenance & Gar. Exp.	\$ 68,656.49	\$ 35,287.53
Transportation Expenses		
Super. Transp. Sals. & Exp.	\$ 3,300.00	\$ 1,696.11
Drivers Wages & Bonuses	55,874.68	28,718.04
Gasoline—Busses	35,446.88	18,218.71
Oil—Busses	1,696.48	871.94
Bus Supplies	313.79	161.28
Other Transp. Exp.	957.87	492.32
Total Transp. Exp.	\$ 97,589.70	\$ 50,158.40
Station Expense		
Company Stations—Sals.	\$ 6,777.51	\$ 3,483.45
Company Stations—Other Exp.	902.71	463.97
Commission Station Exp.	1,310.51	673.57
Total Station Exp.	\$ 8,990.73	\$ 4,620.99
Traffic Promotion & Adv.		
Salaries—Expense	\$ 4,991.17	\$ 2,565.32
Tickets, Baggage Checks, etc.	2,106.39	1,082.63
Tariffs & Schedules	527.46	271.10
Advertising	1,128.35	579.94
Total Traffic Promotion & Adv.	\$ 8,753.37	\$ 4,498.99
Insurance & Safety Exp.		
Workmen's Compensation	\$ 1,009.15	\$ 518.68
Public Liab. & Prop'ty. Damage	24,148.00	12,411.40
Fire & Theft Insurance	802.81	412.62
General Insurance	4,297.44	2,208.77
Total Ins. & Safety Exp.	\$ 30,257.40	\$ 15,551.47
Carried Forward	\$214,247.69	\$110,117.38

(Testimony of George J. Weiser.)

Mr. Sherwood: And this summary page of the exhibits.

The Clerk: Exhibit 7.

(The said summary so offered and received in evidence was marked Petitioner's Exhibit No. 7 and made a part of this record.)

PETITIONER'S EXHIBIT NO. 7

SUMMARY OF OAKLAND-HAYWARD DIVISION DEVELOPMENT LOSSES

Years 1931 to 1935 Inclusive

Year	Amount
1931	\$ 15,613.54
1932	11,230.94
1933	516.47
1934	39,459.22
1935	52,885.41
Total Development Losses.....	<u><u>\$119,705.58</u></u>

[Endorsed]: Petitioner's Exhibit No. 7. Admitted in evidence Oct. 10, 1940. [106]

Direct Examination (resumed)

Q. (By Mr. Sherwood) Mr. Weiser, these figures which you have set forth in Exhibit 7, which is the summary sheet—pardon me. I took yours away from you. This is Exhibit 7 (handing document to the witness).

Do you not include any items of loss sustained by the operation of the inter-city service from Oakland to San Jose, Santa Cruz and Palo Alto?

(Testimony of George J. Weiser.)

Mr. Mather: Now, if your Honor please, I will have to object to that as leading.

Mr. Sherwood: It is leading, your Honor. I will be glad to reframe it.

The Member: Reframe the question.

Q. (By Mr. Sherwood) I will just ask you, Mr. Weiser, what portion of the company's operations was covered by the summary sheet which is Exhibit 7, which purports to show losses.

A. The Oakland-Hayward operation only.

Q. And does it include anything other than that local operation? [48]

A. It does not.

Mr. Sherwood: It will be stipulated, Mr. Mather, that the copy of the agreement of sale between the petitioner and the Railway Equipment and Realty Company, Ltd., which is annexed to the petition on file, is a true and correct copy of that agreement and may be in evidence as such?

Mr. Mather: Well, apparently, Mr. Sherwood, that was not admitted in the answer, and I have never seen the agreement. Do you have the agreement here?

Mr. Sherwood: It was my understanding that this exhibit is in here because it was included in the Revenue Agent's report itself.

Mr. Mather: Well——

Mr. Sherwood (Interposing): As an exhibit to the report. Pardon me.

Q. (By Mr. Sherwood) Have you the original with you, Mr. Weiser?

A. I don't believe I have the original with me.

(Testimony of George J. Weiser.)

Q. You are familiar with the exhibit here?

A. That is correct.

Q. And it was prepared under your direction; was it not? A. The exhibit?

Q. Yes, on your petition.

A. You have reference to the contract between—
—I did not prepare that. [49]

Q. You have read it and are familiar with it?

A. I have read it and was one of the parties that signed it.

Mr. Mather; Just show him a copy.

Q. (By Mr. Sherwood) I will show you a copy of what purports to be the contract which is annexed to the petition, and ask you to look at it and ask you if that is the agreement that was signed.

The Member: Suppose you take the original and let him identify that?

Mr. Sherwood: Yes, your Honor.

Q. (By Mr. Sherwood) Look at this copy. That was annexed to the petition on file with the Board.

A. (Examining documents.)

The Member: You say that that is a correct copy of the agreement?

The Witness: Yes.

Mr. Sherwood: It is stipulated, then, that the copy attached to the petition may be admitted into evidence as a correct copy of the original?

Mr. Mather: That is agreeable, your Honor.

The Member: Very well.

Mr. Sherwood: Excuse me a moment while I check my file (examining document).

(Testimony of George J. Weiser.)

Q. (By Mr. Sherwood) Mr. Weiser, did you prepare the [50] income tax returns and amended returns for the petitioner during the years from 1931 to 1935, inclusive? A. I did.

Q. And what action did you take in regard to the losses shown on Exhibit 7 for the years 1931 to 1934, inclusive?

A. The losses sustained were deducted as ordinary losses for the years 1931 to 1934, inclusive, in the original returns.

Q. What was done in 1935?

A. In 1935 our tax return was filed whereby we capitalized the loss, development loss, on the Oakland-Hayward local division.

Q. Was that return ever audited by a representative of the Internal Agent in charge at San Francisco? A. Yes, it was.

Q. Did you receive any communication from the Internal Revenue agent in charge relative to the report? A. I did.

Q. Was the return accepted as filed?

Mr. Mather: That is objected to as calling for a conclusion of the witness.

The Member: Sustained.

Mr. Sherwood: I will come back to that, your Honor, in just a moment when I have the letter.

Q. (By Mr. Sherwood) What further proceeding was had [51] regarding the returns for 1931 to 1934?

(Testimony of George J. Weiser.)

A. I prepared amended returns for the years 1931 to 1934, inclusive, in which these development losses were capitalized.

Q. Did you make any entries in your books showing the capitalization of your losses in the aggregate sum of \$119,835.41?

A. \$119,705.58 is the figure, and those items were entered on our records at the time that the amended returns were filed.

Q. Can you state——

The Member (Interposing): Well, do I understand from that that the answer is “yes” to the question that was put?

The Witness: Yes, with the exception of the amount—correction as to the amount.

Mr. Sherwood: As to the amount, the witness corrected it.

Q. (By Mr. Sherwood) Can you state the reason why the original returns took these amounts as losses, and the amended returns were filed, showing them as capital investments?

A. I filed the returns for the years 1931, '32, '33, and '4 without any special thought or discussion of the matter with anyone; just indicated them as ordinary expenses and deducted them as such.

However, as the possibility of sale was being discussed [52] in our organization in the very late part of 1935, some of our directors felt that there was going to be quite a tax problem involved and felt that I should secure advice in connection with it,

(Testimony of George J. Weiser.)

whereupon I consulted a few accountants and reviewed the situation with them, and they advised me that it was their opinion that I had filed my 1931, 1932, '3 and '4 returns in correctly; that I had included extraordinary expenses as ordinary expenses. And they suggested that I file amended returns, and likewise for the year 1935 I filed my return on the basis whereby the item of loss on the Oakland-Hayward operation was capitalized.

Q. Did the officials of the company at the time the new development was contemplated in 1931——

The Member (Interposing): Now, don't make this leading. I sense a leading question before you ask it. You had better reframe it.

Mr. Sherwood: I am going to try to avoid that, your Honor.

The Member: "Did they do so and so" usually calls for a "yes" or a "no" answer, and it is an easy way to suggest to the witness what you want him to say.

Mr. Sherwood: I was going to ask, your Honor, if they discussed——

The Member (Interposing): You will commit the same fault if you talk about it. The thing I want to do is get [53] this witness' own fresh testimony and not this suggested testimony.

Mr. Sherwood: I think, your Honor, I can ask the question without indicating the answer I want, but it necessarily will have to call for a "yes" or "no" answer, I believe, to start with.

(Testimony of George J. Weiser.)

Q. (By Mr. Sherwood) Mr. Weiser, was there any discussion or conversations held by the officials of the company about the time the company was investigating the possibility of opening up this new route, regarding whether the route would be immediately profitable or not?

A. Yes, there was discussion.

Q. Now, would you state the gist of the conclusions expressed by the officials?

Mr. Mather: That is objected to, unless the question is made more specific, who talked to whom, and what the conversations were.

This is a corporation, and I think that the conversations that you are discussing, names and dates and places are important.

The Member: I will sustain the objection.

Mr. Sherwood: I will attempt to comply with counsel's suggestion, your Honor.

Q. (By Mr. Sherwood) May I ask: How many directors does the company have?

A. The company has five directors. [54]

Q. How many people own any substantial amount of stock in the company?

A. Four of those directors.

Q. Four of the same five directors?

A. That is correct.

Q. Will you state the names of these people?

A. J. B. Held, S. H. Dunbar, D-u-n-b-a-r, B. A. Perry, P-e-r-r-y, H. D. Gaeta, G-a-e-t-a—you just wanted the stockholders?

(Testimony of George J. Weiser.)

Q. Do those four people you have mentioned own substantially all of the stock of this company?

A. They own all of the stock of the company.

Q. They own all of it. And they are four of the five directors?

A. That is correct.

Q. Who is the fifth director?

A. I am.

Q. And these four gentlemen are the men you referred to a while ago as being the original operators before they incorporated the business in one business?

A. That is correct.

Q. Did you five directors hold any meetings, either formal or informal wherein the matter of the proposed extension of bus service between Hayward and Oakland was discussed?

A. Yes, many of them. [55]

Q. Will you state with as much particularity as you can where those meetings were held and the approximate times?

A. No, it would be extremely difficult for me to do, Mr. Sherwood, because there were so many of these meetings of an informal type. Our organization is not large. It is a small organization. And we are all actively engaged in the business, and we see each other many times during the course of the day. And these things are apt to come up for discussion at most any time, and they did.

Q. But can you definitely recall that there were meetings at about the time this development was undertaken, in which the matters of the development were discussed?

(Testimony of George J. Weiser.)

A. Yes, I can recall that there were meetings.

Q. Well, now, going back to the question that I asked a while ago, was the matter of the possible realization of immediate profit from the new operation discussed at these informal meetings?

A. It was.

Q. Can you state the gist of the discussions?

A. We realized that we would have to perform this service at a loss for several years if we undertook the settlement program in the manner in which we did undertake it.

Q. Were any alternative manners discussed?

A. Yes.

Q. Will you state what they were? [56-57]

A. I believe I made mention of that earlier, and that is the installation of a skeleton service, one that would give service to those who were then residing in the territory. It would of necessity be a very skimpy service without a great deal of frequency.

Q. Was that discussed as an alternative to some other plan? A. (Pause)

Q. Mr. Weiser, when you mentioned those matters a while ago, you said the company felt—what I am trying to do is get testimony as to whether the individual said so-and-so, not what they felt. I understand the reason you are hesitating is that you think you have already covered this matter but I would like to have in the record as to what happened, but not as to what some indefinite individual said.

(Testimony of George J. Weiser.)

A. It was the unanimous consensus of opinion of the directors that of the two plans of development before them, one the so-called "skeleton service," the other the "extra frequency service," the opinion of the Board was that the extra frequency service would produce development of the area in a much faster period of time with quicker and greater ultimate profit to the company after development had occurred than would the skeleton plan, and it was therefore decided to institute the extra-frequency service method of development.

Q. Can you state whether or not the matter of actual loss [58] was discussed?

A. Yes, it was discussed.

Q. What was said about that?

Mr. Mather: That is objected to unless the time, place, and date is fixed.

The Member: We will take a recess for five minutes.

(Whereupon a brief recess was taken, after which proceedings were resumed, as follows:)

Mr. Sherwood: You may cross examine.

Cross Examination

Q. (By Mr. Mather) Mr. Weiser, under what authority were operations carried on prior to 1931?

A. Under a certificate of public convenience and necessity granted by the State Railroad Commission.

Q. Was there any different authority granted in 1931?

A. There was not.

(Testimony of George J. Weiser.)

Q. And the service that you rendered between Oakland and Hayward in 1931 was carried on under the same franchise that had been granted prior to that date?

A. Under the same certificate, yes.

Q. Yes. When did you get a new certificate or an additional certificate?

A. During the latter part of 1933.

Q. Was it issued prior to 1934?

A. I believe it was. [59]

Q. Do you know——

A. (Interposing) Or, I don't have the exact date with me. But it was either the latter part of 1933 or the very early part of 1934.

Q. Now, what did that provide for?

A. That provided authority for us to serve the San Lorenzo and Castro Valley areas which are shown on this map in green.

Q. Yes. And also a direct route on East 14th Street?

A. That is correct.

Q. Now, what do you mean by "skimpy service"?

A. That is a little bit difficult to answer, but maybe I can illustrate it in this way: Where there is a sparse settlement in the community, or in a community, there may exist a need at that time for those living in the community for a bus or two during working hours in the morning, and then possibly returning those people at night to their homes from their work, with the possible addition of an

(Testimony of George J. Weiser.)

occasional schedule during the day for shopping purposes, and particularly by "skimpy," I meant a service that would show little or no loss, or possibly a small profit.

Q. Well——

A. (Interposing) Of course it would be designed to only render a service for those who were then living in the community.

Q. By "skimpy service," then, do you mean a service [60] commensurate with the demand occasioned at that time?

A. Commensurate—a service commensurate with the existing needs of the then residents of the territory.

Q. This service that you rendered in '31 between Oakland and Hayward, 20-minute service, was that over the same route that you operated prior to that time? A. That is correct.

Q. And you had been operating a through service on this same route for a number of years?

A. An inter-city service over that route, yes.

Q. In other words, you put on additional buses that went over the same place, a service every 20 minutes?

A. In 1931, '32, and '3; that is correct.

Q. How many additional buses did you put on at that time?

A. I can't answer that without referring to our plant account.

Q. What other services were being rendered by competing companies at that time?

(Testimony of George J. Weiser.)

A. At that time and for a number of years prior thereto there was a street car line in operation between Oakland and Hayward.

Q. And that operated through all these years; did it not? A. Yes.

Q. Now, what increase in population was there in this area in 1931? [61]

A. I can't answer the question specifically, but I know from personal observation that there was an increase in population in the area which we served immediately following the institution of this new local service of Peerless.

Q. And that apparently would be the latter part of 1931; would it not?

A. It followed shortly on the heels—that is, some development commenced immediately upon the institution of the service.

Q. There were subdivisions and building going on in that area prior to '31, was there not?

A. There were some subdivisions in the territory where owners of property were attempting to sell their lots for home development, but were not succeeding particularly well because of the lack of suitable transportation facilities.

Q. What in your opinion was the increase in population from '31 to '36?

A. It would be difficult for me to hazard a guess. I merely know that in this area where heretofore you could see acre after acre of orchard land and tomato land, you now find block after block of homes.

(Testimony of George J. Weiser.)

Q. Referring to Petitioner's Exhibit 2, and to Petitioner's Exhibit 7, Mr. Weiser, I am not entirely clear as to what the \$15,613.54 represents. Will you tell me?

A. The \$15,613.54 represents the losses sustained—or, [62] rather, represents the difference between the amounts expended in operating on the Oakland-Hayward local operation during 1931 and the receipts received from that operation during the year 1931.

Q. Well, now, can you pick those out on Exhibit 2, which I understand to be the total operations?

A. Exhibit 2 covers both the total operations and to the right, the right-hand columns, represent the results of the Oakland-Hayward operation which are included in the figures shown for the total of all divisions.

Q. Well, then, the item, "\$15,613.54" appearing for the year 1931 on Exhibit 7 is simply your ordinary cost of operations of your Hayward-Oakland transportation system, is that not?

A. I wouldn't say they were our ordinary costs. I would say they were the difference between the costs of performing that service and the actual receipts.

Q. Well, does Exhibit 2 show you the expenses in connection with that operation?

A. That is correct.

Q. Pick out for me the extraordinary costs in Petitioner's Exhibit 2.

(Testimony of George J. Weiser.)

A. I feel that all items of expenses shown there when totaled, and to the extent that they exceed the receipts of the operation, are extraordinary expenses. [63]

Q. Well, just pick out the extraordinary expenses in Petitioner's Exhibit 2; enumerate them for me.

A. Well, there are extraordinary expenses included in drivers' wages, gasoline, oil, service car expenses, station salaries, station expenses, shop expenses, miscellaneous transportation expense, and every item of expense that is shown hereon.

Q. All right. Now, take drivers' wages, the item set up there as \$11,733.91. What did that represent?

A. That represented the amounts paid to drivers operating buses on the Oakland-Hayward local operation.

Q. What did those drivers do?

A. Performed all duties required of drivers, which is the operation of the bus, collecting fares from passengers, handling passengers' baggage, and so forth.

Q. All right. Now, wherein did their services differ from the services of your drivers operating on your through service?

A. In a general way, there was no difference so far as the actual service which they perform. However, there was this extra frequency of service.

Q. They had to stop more often?

A. No. I mean by that that there were more

(Testimony of George J. Weiser.)

drivers working on the Oakland-Hayward buses than the immediate needs of the territory. [64]

Q. Well, by that do you mean that you did not have enough customers who were paying fares to warrant the number of drivers that you had?

A. You might put that interpretation on it.

Q. Now, tell me with respect to the gasoline, the extraordinary expense in connection with that.

A. In a general way, the same thing holds true of gasoline as holds true of drivers' wages. These amounts were expended for gassing the buses operating on the Oakland-Hayward local operation.

Q. Is that true for all the items for all the years? A. That is correct.

Q. Well, I am a little confused, Mr. Weiser, about Exhibit 3, the left-hand column of which appears to show the Oakland-Hayward operation.

Now, on Petitioner's Exhibit 7 the loss, I think, is \$11,230.94 for '32, and where does that appear on Exhibit 3?

A. It is the last figure in the right-hand column of Exhibit 3.

Mr. Sherwood: Which page?

The Witness: Of page 2.

Q. (By Mr. Mather) Well, then, that represents net operating loss of some \$13,000 on the Hayward division plus an adjustment for income taxes of \$2,000?

A. That is correct. There are certain items of self-insurance [65] which the Commissioner has not permitted us to deduct.

(Testimony of George J. Weiser.)

Q. Now, with respect to these discussions in connection with the operation of the Hayward-Oakland service, when that was instituted was there any formal action taken by your board of directors?

A. During 19—you are referring to the institution of service in 1931?

Q. That is correct.

A. I feel that there was some formal action taken by the board because it involved the acquiring of additional buses, and I know that that matter is spread on the minutes of the company, the acquisition of additional equipment. And there may be some further explanation as to just why the need for this additional equipment arose, as spread on the minutes.

Q. You testified, I believe, Mr. Weiser, that you prepared the returns of this petitioner for all of the years '31 to and including '36?

A. That is correct.

Q. And also the amended returns that were prepared?

A. That is correct.

Q. And claims for refund were filed. Did you prepare those also, with respect to the amended returns?

A. I either filed the claims for refund myself or caused them to be prepared.

Q. And claims for refund for all of the years in which [66] amended returns were filed have been filed; have they not?

A. (Pause)

Q. From '31 to '35?

(Testimony of George J. Weiser.)

A. With the exception of the year 1932, that is correct. No claim for refund for '32, as my memory serves me, was filed.

Mr. Mather: No further cross examination.

The Member: Have you more from this witness?

Mr. Sherwood: No more, your Honor.

The Member: Stand aside.

(Witness excused.)

Mr. Sherwood: By the way, for the record I would like to correct my opening statement. Your Honor probably has already discovered that I was in error, and Mr. Mather was correct in saying that they did not get two certificates from the Railroad Commission. I said they got one in '31 and one in '34, and I was in error. I thought they had, but the witness says they did not.

The Member: We will suspend now until 2:00 o'clock.

(Thereupon at 12:30 o'clock p. m., a recess was taken until 2:00 o'clock p. m. of the same day.)

[67]

Afternoon Session

2 o'Clock P. M.

(Brief interruption for other matters.)

The Member: Are you still cross examining the witness?

Mr. Mather: No, if your Honor please. I have completed my cross examination.

However, in connection with his testimony, we have agreed that it may be stipulated that the amended returns covering the years 1931, 1932, 1933 and 1934 in which development expense was capitalized were filed with the Collector of Internal Revenue on May 21, 1936.

Mr. Sherwood: We so stipulate, your Honor.

The Member: Am I to understand that that is the only modification appearing in the amended return from what had appeared in the original returns? That is to say, the elimination from the original returns of the deductions of the amounts of ordinary and necessary expenses which are now claimed to have been the amounts which have been capitalized as to these two routes? I want only your stipulation. I don't want testimony.

Mr. Sherwood: What your Honor says is correct with one exception, namely, the year 1933. The examining agent had questioned some items of depreciation, and the taxpayer adjusted those in accordance with the Revenue Agent's request, which resulted in a slightly larger tax for that year than

they had paid in addition to the deduction for this loss being [68] eliminated.

The Member: Well, I take it it appears plainly on the amended return as a modification of the deduction already taken for depreciation?

Mr. Sherwood: Yes.

The Member: So that it shows on the return as being something entirely unrelated to this issue?

Mr. Sherwood: Yes, I believe that is true, and that the Revenue Agent's—the letter of the Revenue Agent, the 90-day letter upon which this petition was filed which incorporates it, shows all of the facts which will be necessary for us to have in evidence here in order for the Board——

The Member (Interposing): I don't care about that. I am only talking about the amended returns that Mr. Mather spoke about that were filed on that stipulated date.

Mr. Sherwood: Yes.

The Member: All right. Your next witness?

Mr. Sherwood: Mr. Howell.

FRANKLIN D. HOWELL

a witness called on behalf of petitioner, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Sherwood) Your name, please?

A. Franklin D. Howell, H-o-w-e-l-l.

Q. Where do you live, Mr. Howell? [69]

A. Los Angeles, California.

Mr. Sherwood: The next questions, your Honor, will be directed toward qualifying Mr. Howell as an expert.

Q. (By Mr. Sherwood) What is your profession, Mr. Howell?

A. I am a civil and mining engineer, educated at the University of Pennsylvania.

Q. Will you state what educational institutions you attended?

A. The University of Pennsylvania. I have been in practice in the profession for pretty nearly 55 years.

Q. In connection with the practice of your profession, have you been engaged in any phase of the transportation industry?

A. I have been. Probably fifty per cent of that time has been in the transportation industry, either steam or electric railway, or motor bus operation.

Q. Would you state more precisely what you did in connection with your employment in the transportation industry?

A. In the motor bus industry, or all?

Q. All the transportation industry.

A. Construction, operation, valuations, rate making.

Q. Would you give the years and the place?

A. Over 55 years ago. That is a pretty big order.

Q. Could you summarize them briefly, your principal experiences?

(Testimony of Franklin D. Howell.)

A. Well, I say over 50 per cent of it has been transporta- [70] tion, in the bus business, in the freight business, and the automobile business. I have been engaged in that since 1915 with some little railroad work aside from that, but in 1915 I was appointed chief engineer of the Board of Public Utilities of Los Angeles and was there for four years.

Then in connection with all utilities before the Railroad Commission got jurisdiction over the utilities in the city of Los Angeles, and before there was any regulation on the motor bus industry, which did not come in until 1917; on January 1, 1919 I resigned as chief engineer of the public utilities department and went in with the then White Bus Line as general manager; remained as general manager and vice president until 1933 when the property was sold to the Pacific Electric Railway.

Also in 1919 I was one of the organizers of the Motor Carriers Association of this state; was the first secretary-manager, and later vice president, and for the last eight years up to '33 was its president. That association was organized to promote the business and regulate it and get it on a stable transportation basis. And I had a hand in all the regulatory laws that were drawn, and assisted in their passage.

Q. Have you had occasion to appear before state and federal regulatory bodies?

A. Oh, yes, in rail cases, a number of them, and

(Testimony of Franklin D. Howell.)

in practically [71] all utility, gas and electrical, and in the motor bus industry as well.

Q. What public bodies have you appeared before?

A. The State of California; in one, two instances, before the Federal Courts, and before the Interstate Commerce Commission.

Q. The White Bus Line changed took another name?

A. It changed its name to the Motor Transit Company.

Q. In your employment by the Motor Transit Company, what was the general nature of your duties there?

A. Organization and management of the development of the plant, equipment. There we built all our own cars. In the early days of the business we were using passenger cars, touring cars, and overhauling them, pitching them up to larger capacity. But we were the first company to go into building our own.

Q. While you were president of the Motor Transit Company did you have occasion to develop new bus lines in addition to the lines that were in existence when you first went with the company?

A. Motor Transit Company was built up from one short line, Los Angeles and Whittier, into a service throughout the Counties of Los Angeles, San Diego, San Bernardino and Riverside; all started

(Testimony of Franklin D. Howell.)

from one short line, and the additional lines were either developed directly by the Motor Transit [72] Company, or purchased them.

Q. In terms of mileage, how much of a development was that that you have described?

A. Oh, it was about 50 per cent. It went from about four cars up to some 250 cars equipment. It ran from a few miles up to—when we sold it—up to between five and five and a half million car miles a year.

Q. Is there an accounting practice which is generally recognized in the transportation industry and by the state-federal regulatory bodies concerning the proper allocation between ordinary expenses and capital investments attendant upon the development of new transportation facilities?

Mr. Mather: May I ask if that is still directed toward qualification?

Mr. Sherwood: No. This is the first question, Mr. Mather, I wish to ask of this witness.

The Member: That is what he is supposed to be an expert about.

Mr. Mather: I object to that as irrelevant and immaterial.

The Member: Sustained.

Mr. Mather: I object to that as irrelevant and immaterial.

The Member: Sustained. Do you also include "incompetent" in that?

(Testimony of Franklin D. Howell.)

Mr. Mather: No, sir. [73]

The Member: You don't?

Mr. Mather: I don't, no, sir.

The Member: You have excluded "incompetent"?

Mr. Mather: Yes.

The Member: All right. Go ahead.

Q. (By Mr. Sherwood) In the practice of developing bus lines, Mr. Howell, do newly started bus lines usually pay a profit upon the operation from the time of their inception?

Mr. Mather: That is objected to as irrelevant and immaterial.

The Member: Sustained.

Mr. Sherwood: May we have an exception, your Honor?

The Member: You have an exception to every adverse ruling.

Mr. Sherwood: Thank you, your Honor.

Q. (By Mr. Sherwood) Mr. Howell, in the development of a bus service over a route not previously served, are items such as wages for drivers, gasoline and oil which would normally be part of the operating expense of such an operation be classified as "development costs" under any circumstances?

Mr. Mather: That is objected to as irrelevant and immaterial.

The Member: Sustained.

(Testimony of Franklin D. Howell.)

Mr. Sherwood: In order to save time, may I ask your [74] Honor if the objection is to the form of the question or just the general idea that I couldn't prove these things by an expert?

The Member: Just the general idea that the things you are attempting to prove are irrelevant and immaterial.

Mr. Sherwood: Well, there is no use in taking your Honor's time on this matter.

I would say that I might make a tender of proof, just for the record, that what I desire to show by Mr. Howell, he has reduced to written form and I can state exactly what I would like to prove, that there is a general practice recognized by accountants for transportation companies, public utilities, by public utility accountants, and by the State Railroad Commission and the Federal Interstate Commerce Commission which recognizes the fact that early losses, both by the operation of facilities which are in advance of the needs of the community, are capital investments to the extent, and only to the extent, that the cost of rendering the service exceeds the revenue from that particular division.

Th Member: That is what you are proffering now?

Mr. Sherwood: Yes, your Honor.

The Member: All right. I will reject the proffer.

Mr. Sherwood: No more questions of Mr.

Howell. Thank you, your Honor. We have our exceptions in the record?

The Member: Yes. [75]

(Witness excused.)

Mr. Sherwood: We have no further testimony.

The Member: That is your case?

Mr. Sherwood: That is our case.

The Member: Does the Government have any evidence?

Mr. Mather: No, your Honor.

The Member: Your answer is "no"?

Mr. Mather: The answer is "no."

Mr. Lewis: Could we have 40 days, your Honor, to file briefs?

The Member: I don't think you need reply briefs, do you?

Mr. Lewis: I don't know, of course, what would come out in the brief, but from the general——

The Member (Interposing): Unless I am very much mistaken, you haven't got a Chinaman's chance. I shouldn't think the Government would need to file a brief. It seems to me that it is perfectly clear that you can't do what you are attempting to do. I may be wrong about it, and you may be able to convince me in a brief that I am wrong, and you may have 40 days to file a brief, but I don't see any necessity for additional time.

Therefore, the case will be submitted upon your briefs 40 days hence. [76]

Mr. Sherwood: That is satisfactory.

Hearing Concluded.

[Endorsed]: U. S. B. T. A. Filed Oct. 29, 1940.

[77]

[Title of Board and Cause.]

Docket No. 100436. Promulgated December 19, 1940.

Excess of costs over receipts of the operation of a transportation line deducted on returns for earlier years of operation held not properly included in the basis of gain from disposal of the line in a later year.

Clyde C. Sherwood, Esq., and John V. Lewis, Esq., for the petitioner.

T. M. Mather, Esq., for the respondent.

The Commissioner determined a deficiency of \$25,289.85 in income tax and \$9,609.39 in excess profits tax of petitioner for 1936, refusing to allow the operating losses of prior years to be included in the basis for determining profit realized from a sale.

FINDINGS OF FACT.

Petitioner, a California corporation with its principal office in Oakland, was organized in 1923. It took over from four individuals, who became its only stockholders and who were four of its five directors, the operation of a bus transportation system between Oakland, Palo Alto, San Jose, and

Santa Cruz which the four individuals had been operating under a certificate of the California State Railroad Commission.

The area between Oakland and Hayward contained orchard and tomato lands. For several years before 1931 a street car line had been operated between those points. At that time petitioner had given intermediate bus service as part of its intercity service between Oakland and San Jose. Petitioner considered two alternative plans for providing the area with transportation—one, a skeleton service which would merely take care of the existing demand, and the other, a more frequent service at 20-minute intervals. Petitioner adopted the latter plan and in 1931 established a local service in addition to the intercity service. The busses stopped to take on or discharge passengers at any corner. The area developed rapidly. [78]

In 1933 petitioner filed with the State Railroad Commission an application for authority to extend the local bus service to the Castro Valley and San Lorenzo areas. Authority was granted, and in 1934 the new service was instituted on a 20-minute frequency. This service was coordinated with the existing local service, thereby giving 10-minute service to certain areas.

In 1931-1935 the miles traveled, the passenger and express receipts, and the loss from operation of the new local service, computed by deducting from transportation revenues the transportation expenses,

self-insurance charges, and depreciation adjustments, were as follows:

	Miles	Receipts	Loss
1931	282,127	\$ 48,356.91	\$ 15,613.54
1932	328,860	58,230.04	11,230.94
1933	342,513	63,355.05	516.47
1934	753,967	101,640.22	39,459.22
1935	839,046	108,550.72	52,885.41
Total			\$119,705.58

In 1935 petitioner's directors contemplated abandoning the new local routes to another transportation company, and on January 14, 1936, made such a contract, including the sale of 15 busses. The consideration was \$180,000 plus \$30,000 as reimbursement for petitioner's local service operating deficit from April 1 to December 31, 1935, and a sum equal to petitioner's local service operating deficit from January 1, 1936, to the date of actual abandonment of the local service.

On its income tax returns for 1931-1934, petitioner deducted the losses from operation of the new routes. On May 21, 1936, amended returns were filed for these years, and on them and on the return for 1935 these losses, aggregating \$119,705.58, were treated as having been capitalized.

OPINION

Sternhagen: On its return for 1936 petitioner reported a capital gain of \$92,334.14, by including in its basis the \$119,705.58 aggregate losses from

the operation of the services from Oakland to Hayward, Castro Valley, and San Lorenzo. These amounts for each year through 1934 had been used by petitioner as deductions in computing its taxable income, either as operating expenses or losses. The Commissioner increased the gain from the transaction in 1936 by excluding the \$119,705.58 from the basis, saying "there is no authority under the provisions of section 113 (b), Revenue Act of 1936, to capitalize as the cost of the franchise the operating losses of the years 1931 to 1935, inclusive." Petitioner contends that the general excess of operating expenses over operating receipts from the new routes were capital expenditures not properly deductible in the year of operation.

The Commissioner's determination is correct. So far as the evidence shows, the losses in question were entirely operating expenses and petitioner properly took deductions for them in the respective years of operation. The fact that the new operation resulted in greater expenses than receipts is not alone reason to capitalize them. Had there been expenditures which could be identified as not attributable to current operation but directly and clearly to capital, there might be some ground for permitting or even requiring a taxpayer to omit them from current deductions and charging them to "capital account" as contemplated by section 113 (b) (1) (A). This has been held in respect of the cost of solicitation of new business and of free serv-

ice given to build good will. *Houston Natural Gas Corporation v. Commissioner*, 90 Fed. (2d) 814; cf. *News Publishing Co. v. Blair*, 29 Fed. (2d) 955; *Successful Farming Publishing Co. v. Commissioner*, 64 Fed. (2d) 890. But nothing in the evidence would have supported such treatment in the years of expenditure, and nothing supports such treatment in the later year when the business was discontinued. The excessive cost of current operation would not be regarded as invested capital for the purpose of measuring excess profits under the earlier statutes.

Decision will be entered for the respondent. [80]

United States Board of Tax Appeals
Washington

Docket No. 100436

PEERLESS STAGES, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

In accordance with the Board's report, promulgated December 19, 1940, it is

Ordered and Decided that there are deficiencies

for 1936 of \$25,289.85 in income tax and \$9,609.39 in excess profits tax.

Enter:

Entered Dec. 20, 1940.

(s) J. M. STERNHAGEN,

Member. [81]

[Title of Board and Cause.]

PETITION FOR REVIEW BY THE UNITED
STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT.

To the Honorable, the Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:

Now comes the petitioner, Peerless Stages, Inc.,
and respectfully shows:

I.

Jurisdiction

The petitioner on review, hereinafter referred to as the taxpayer, is a California corporation. Said taxpayer filed a federal income-tax return for the calendar year 1936 with the Collector of Internal Revenue for the First District of California, located in the City of San Francisco, State of California, and within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit.

The respondent on review is the duly appointed, [82] qualified, and acting Commissioner of Internal Revenue of the United States, hereinafter referred

to as the Commissioner, holding his office by virtue of the laws of the United States.

II.

Nature of Controversy

The taxpayer is a California corporation organized in 1923, which operated a bus transportation system between Oakland, Palo Alto, San Jose, and Santa Cruz under a certificate of the California State Railroad Commission.

The area between Oakland and Hayward contained much undeveloped acreage. In 1931 the directors of taxpayer considered providing the area with transportation, realizing that inasmuch as the taxpayer performed no service locally within the City of Oakland, it was dependent upon such territory if it wished to develop its operative right. A survey was made upon which it was found that there was available in this area an abundance of homesites, ideal from the point of view of climatic conditions and price; and it was also found that unless frequent, economical transportation service was provided for commuters, shoppers, students, and those attending business, the settlement of such area would be greatly retarded.

The directors of taxpayer considered two alternative plans for providing the area with transportation: one, a skeleton service which would merely take care of the existing demand; and the other, a more frequent service at [83] twenty-minute intervals. The latter plan was adopted in 1931, the di-

rectors of the taxpayer believing that such service would develop the territory, which in turn would develop an operative right of great value. Patronage gradually increased during the years 1931, 1932, and 1933, at which time the receipts of the operation had been brought to a point that almost equaled the annual expense of the operation, and the development phase of that operative right was about completed.

In 1933, however, taxpayer filed an application with the California State Railroad Commission for authority to extend the local bus transportation service to the Castro Valley and San Lorenzo areas, which areas, as in the former case, were sparsely settled because of the lack of suitable transportation facilities.

In 1934, upon authority being granted, the new service was instituted on a twenty-minute frequency. This service was coordinated with the existing local service, thereby giving ten-minute service to certain areas. The cost of this extra frequency of service over and above immediate needs was not incurred for immediate benefit, but was a definite cost incurred for the benefit of future years.

In 1931-1935 the miles traveled, the passenger and express receipts, and the loss from operation of the new local service, computed by deducting from the transportation revenues the transportation expenses, self-insurance charges, and depreciation adjustments, were as follows: [84]

	Miles	Receipts	Loss
1931	282,127	\$ 48,356.91	\$ 15,613.54
1932	328,860	58,230.04	11,230.94
1933	342,513	63,355.05	516.47
1934	753,967	101,640.22	39,459.22
1935	839,046	108,550.72	52,885.41
Total			<hr/> \$119,705.58

Railway Equipment and Realty Company, Ltd., applied for and received a permit to operate transportation facilities over the same territory. On January 14, 1936 the taxpayer sold out its local routes to its competitors. Certain equipment was sold for a specific price, and in addition the Railway Equipment and Realty Company, Ltd., agreed to pay the taxpayer to abandon its local routes to it. The consideration was \$180,000 plus \$30,000 as reimbursement for taxpayer's local service operating deficit from April 1 to December 31, 1935, and a sum equal to taxpayer's local service operating deficit from January 1, 1936 to the date of actual abandonment of the service.

Under the aforesaid contract the taxpayer reported as taxable income in its corporation and excess-profits tax return for the calendar year 1936 a capital gain of \$92,334.74, which amount represented the profit made on the abandonment of the operative rights. In its accounting records for the calendar year 1935 the taxpayer capitalized the sum of \$119,705.58, representing the cost of development of the operative rights. Amended income-tax

returns for the calendar years 1931 and [85] 1932, and amended income and excess-profits tax returns for the calendar year 1934 were filed with the Collector of Internal Revenue, San Francisco, California, on May 18, 1936. On them and on the income-tax return for 1935, these losses were treated as having been capitalized. The return for 1935 was accepted as correct after a field examination and audit by the Internal Revenue Agent in Charge, San Francisco.

The United States Board of Tax Appeals approved the Commissioner's redetermination of excluding the \$119,705.58 from the basis, and thereby increasing the gain from the transaction in 1936, on the thesis that there was no authority under the provisions of section 113(b), Revenue Act of 1936, to capitalize as the cost of the franchise the operating losses of the years 1931 to 1935, inclusive. The contention of the taxpayer is that this determination is in error and that the annual deficit of operation of the new bus lines as capitalized represented the cost of development of the operative rights and should not be treated as expenses deductible solely in the year of operation.

III.

ASSIGNMENT OF ERRORS

The taxpayer avers that in the record and proceedings before the United States Board of Tax Appeals and in the opinion and final decision rendered and entered by the United States Board of

Tax Appeals, manifest error occurred and [86] intervened to the prejudice of the taxpayer, which now assigns the following errors and each of them, which it avers occurred in said record, proceedings, opinion and final decision so rendered by the United States Board of Tax Appeals:

1. In determining the taxable net income of the taxpayer for the calendar year 1936 the Board of Tax Appeals erroneously affirmed the action of the Commissioner in increasing the income \$119,705.58.

2. Error was committed by the Board of Tax Appeals in failing to allow the taxpayer a cost basis of \$119,705.58 for the developed operative rights, which rights the taxpayer agreed to abandon to the Railway Equipment and Realty Company, Ltd., under its contract with that company.

3. Error was committed in the determination that under the Revenue Act of 1936, the taxpayer had no authority to capitalize the cost of development of the operative rights.

4. Error was committed in holding that the expenditures were attributable to current operation and not to capital when such expenditures were made directly and in contemplation of creating a valuable and developed operative right.

5. Error was made in rejecting the proffer of evidence to show that there is a general practice recognized by accountants for transportation companies and public utilities, by the California State Railroad Commission and by the United States Interstate Commerce Commission, which establishes

that early losses, caused by the operation of facilities [87] which are in advance of the needs of the community and to build the community, are capital expenditures to the extent that the cost of rendering the service exceeds the revenue.

Wherefore, taxpayer respectfully petitions that the decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to end the errors complained of by review of said Court.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Petitioner,

333 Montgomery Street,

San Francisco, California. [88]

State of California,

City and County of San Francisco—ss.

Clyde C. Sherwood, being duly sworn, says: I am one of the attorneys for the petitioner in this proceeding; I prepared the foregoing petition and am familiar with the contents thereof. The allegations of fact contained therein are true to the best of my knowledge, information, and belief. This petition is not filed for the purpose of delay, and I believe the petitioner is justly entitled to the relief sought.

CLYDE C. SHERWOOD

Subscribed and sworn to before me this 6th day of March, 1941.

[Notarial Seal] LOUIS WIENER,
Notary Public in and for the City and County of
San Francisco, State of California.

[Endorsed]: U. S. B. T. A. Filed March 11, 1941.

[89]

[Title of Board and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Commissioner of Internal Revenue,
Internal Revenue Building,
Washington, D. C.

J. P. Wenchel, Attorney for Respondent,
Chief Counsel, Bureau of Internal Revenue,
Internal Revenue Building, Washington,
D. C.

You Are Hereby Notified that on the 11th day of March, 1941, a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the United States Board of Tax Appeals heretofore rendered in the above-entitled cause, was filed with the Clerk of the Board. A copy of the petition as filed is attached hereto and served upon you.

Dated: March 6th, 1941.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Petitioner,

333 Montgomery Street,

San Francisco, California. [90]

Service of the foregoing notice of filing and of a copy of the petition for review is hereby acknowledged this 11th day of March, 1941.

J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue,

Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed July 16, 1941.

[91]

[Title of Board and Cause.]

STIPULATION THAT EXHIBITS SHALL BE INCLUDED IN RECORD ON APPEAL.

It Is Hereby Stipulated by and between Peerless Stages, Inc., petitioner, by and through its attorneys Clyde C. Sherwood and John V. Lewis; and the Commissioner of Internal Revenue, respondent, by and through his attorney J. P. Wenchel, that the Clerk of the United States Board of Tax Appeals shall include in the record on appeal with the transcript of the evidence prepared by the stenographic reporter, the exhibits which were admitted in evidence in the above-entitled matter.

Dated: July 22nd, 1941.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Petitioner,

333 Montgomery St.,

San Francisco.

J. P. WENCHEL,

Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed July 26, 1941.

[92]

[Title of Board and Cause.]

DESIGNATION OF THE PORTIONS OF THE
RECORD, PROCEEDINGS, AND EVIDENCE
TO BE CONTAINED IN THE
RECORD ON APPEAL.

To: The Clerk of the United States Board of Tax Appeals, Internal Revenue Building, Washington, D. C.;

To: The Commissioner of Internal Revenue and to J. P. Wenchel, Attorney for Respondent, Chief Counsel, Bureau of Internal Revenue, Internal Revenue Building, Washington, D. C.

You and Each of You Are Hereby Notified that the petitioner above named hereby designates the portions of the record, proceedings, and evidence to be contained in the record on appeal as follows, to-wit:

1. The docket entries.

2. The petition to the Board of Tax Appeals.
3. The answer of the Commissioner.
4. The entire transcript of the evidence prepared by the stenographic reporter. [107]
5. The findings of fact, opinion, and decision of the Board of Tax Appeals.
6. The petition for review by the United States Circuit Court of Appeals for the Ninth Circuit and the assignment of errors therein contained.
7. Notice of filing petition for review and assignment of error.
8. This notice designating the portions of the record, proceedings, and evidence to be contained in the record on review.

Dated at San Francisco, California, July 11th, 1941.

CLYDE C. SHERWOOD,
JOHN V. LEWIS,
Attorneys for Petitioner,
333 Montgomery St.,
San Francisco, California.

Service of the foregoing Designation of the Portions of the Record, Proceedings, and Evidence to be Contained in the Record on Appeal, is hereby acknowledged this 17th day of July, 1941.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

[Endorsed]: U. S. B. T. A. Filed July 17, 1941.

[108]

[Title of Board and Cause.]

CERTIFICATE

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 108, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 2nd day of August, 1941.

[Seal]

B. D. GAMBLE,

Clerk, United States Board of Tax Appeals.

[Endorsed]: No. 9891. United States Circuit Court of Appeals for the Ninth Circuit. Peerless Stages, Inc., a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed August 9, 1941.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
For the Ninth Circuit

No. 9891

PEERLESS STAGES, INC.,

Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF FACTS UPON WHICH AP-
PELLANT INTENDS TO RELY AND
DESIGNATION OF RECORD TO BE
PRINTED.

To the Clerk of the United States Circuit Court of
Appeals for the Ninth Circuit; and

To Samuel O. Clark, Jr., Assistant United States
Attorney General; and J. P. Wenchel, Esq.,
Chief Counsel, Bureau of Internal Revenue:

You and Each of You Are Hereby Notified that
appellant hereby adopts as its statement of points
upon which appellant intends to rely on appeal, the
assignment of errors contained in appellant's peti-
tion for review by the United States Circuit Court
of Appeals for the Ninth Circuit. Appellant hereby
designates for printing the entire transcript of pro-
ceedings before the United States Board of Tax
Appeals.

Dated: August 11th, 1941.

CLYDE C. SHERWOOD,

JOHN V. LEWIS,

Attorneys for Appellant,
333 Montgomery Street,
San Francisco, California.

AFFIDAVIT OF SERVICE BY MAIL

[C. C. P. 1013A]

State of California,

City and County of San Francisco—ss.

Margaret Moore, being sworn, says that she is a citizen of the United States, over 18 years of age, a resident of Alameda County, and not a party to the within action.

That affiant's residence (business) address is 5631 Florence Avenue, Oakland, California.

That affiant served copies of the attached statement of facts upon which appellant intends to rely and designation of record to be printed by placing said copies in an envelope addressed to Samuel O. Clark, Jr., Assistant United States Attorney General, at his office (residence) address, Justice Building, Washington, D. C.; and in an envelope addressed to J. P. Wenchel, Esq., Chief Counsel, Bureau of Internal Revenue, at his office address, Internal Revenue Building, Washington, D. C., which envelopes were then sealed and postage fully prepaid thereon, and thereafter were on August 11,

1941 deposited in the United States mail at San Francisco, California.

That there is delivery service by United States mail at the place so addressed, or regular communication by United States mail between the place of mailing and the place so addressed.

MARGARET MOORE

Subscribed and sworn to before me on August 11th, 1941.

[Seal] LOUIS WIENER,

Notary Public in and for said County
and state.

[Endorsed]: Filed Aug. 12, 1941. Paul P.
O'Brien, Clerk.

